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AGRICULTURAL CONSOLIDATION AND THE SMITHFIELD/FARMLAND DEAL

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SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS

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AGRICULTURAL CONSOLIDATION AND THE SMITHFIELD/FARMLAND DEAL

WEDNESDAY, JULY 23, 2003

UNITED STATES SENATE,
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS, OF THE COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 4:03 p.m., in room SD–138, Dirksen Senate Office Building, Hon. Mike DeWine, Chairman of the Subcommittee, presiding.

Present: Senators DeWine and Kohl.

OPENING STATEMENT OF HON. MIKE DEWINE, A U.S. SENATOR FROM THE STATE OF OHIO

Chairman DEWINE. Good afternoon. Welcome to the Antitrust Subcommittee. Today's hearing will examine the Smithfield/Farmland deal as well as horizontal consolidation and, perhaps more importantly, vertical integration in the agriculture industry.

Horizontal consolidation has become a common sight in many industries in recent years as mergers among direct competitors have increased the size and scope of companies, even while decreasing the number of companies left to compete. The pros and cons of horizontal consolidation also have become well known as antitrust enforces and this Subcommittee have weighed and balanced claims of increased efficiencies versus concerns of market dominance and decreased innovation.

The evaluation of vertical integration and its effects is often more difficult. Vertical integration within the agricultural sector, which we will examine today in this Committee, is, of course, no different. Increasingly over time, we have seen packers create arrangements where the own or control their sources of supply. This vertical integration often raises competitive concerns that packers will refuse to purchase from any non-integrated source, decimating the spot market and leaving independent farmers with ever decreasing opportunities to sell their products. The loss of these market opportunities may lead to the loss of more independent farmers and to greater horizontal consolidation at the producer level.

Along with these potential harms comes a potential upside. It is clear that vertical integration may generate efficiencies and other benefits. For example, many farmers sell their hogs under the system of contract farming, which is a form of vertical integration. Specifically, the farmer agrees to raise the hogs in a certain manner and under certain conditions. In return, the package guarantees a set price. This provides the packer with a reliable source of

product and allows the farmers to bank on the certainty that those contracts provide against volatile market price swings. In addition, many believe that vertical integration has increased the ability of the livestock-processing industry to meet the demands of their retain customers—demands for higher-quality products, reliable delivery, and national distribution—all of which also allow industry to compete more effectively in the international market.

The specific deal before us today is somewhat unusual in that it may not raise all of the concerns that horizontal consolidation raises. As an initial matter, we have to note that the pork-processing market is less concentrated than other protein markets, such as beef, where the top four processors control 80 percent of the market. As a result, this deal does not automatically trigger the types of concerns that further horizontal consolidation in those markets might trigger.

Of course, the deal still requires antitrust review, and there is some limited horizontal overlap in the areas where both Smithfield and Farmland buy hogs. Even in those areas of overlap, however, there may be enough remaining pork processors that no antitrust harm may result from this deal.

This deal is also unusual because Farmland Industries is bankruptcy. Smithfield's purchase of Farmland's pork-processing operations means that those operations will go from being part of a company floundering in bankruptcy, with all of the uncertainty that accompanies bankruptcy, to being part of a strong stable company in Smithfield.

Now, despite these unusual aspects, overall this deal and the trends of horizontal consolidation and vertical integration in agriculture give us a lot to discuss today. This Subcommittee has been and continues to be committed to achieving and maintaining an agriculture industry that is a highly competitive industry—an industry which can and should benefit all its participants, including producers, processors, and consumers. We look forward to hearing from our witnesses on all of these important issues today.

Now let me turn to my friend and colleague and the Ranking Member of this Committee, Senator Kohl.

STATEMENT OF HON. HERB KOHL, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KOHL. Mr. Chairman, thank you for holding this important hearing today. Concentration and consolidation in the agricultural industry is a major concern for hard-working families and farmers across our country. Today we are examining the merger between Smithfield and Farmland, combining the Nation's number one and number five pork processors, but this deal represents just one of many that have occurred in recent years throughout our agricultural economy.

The increased numbers of mergers and acquisitions among the Nation's top processing firms raises serious concerns about whether there is a competitive market that enables our farmers to have a fair chance to receive a fair price for their products. Our Nation's farmers, who comprise less than 2 percent of the population, produce the most abundant, wholesome, and by the cheapest food on the face of the Earth.

However, the way in which food is produced is rapidly changing, creating significant new challenges. We have seen a massive reorganization in our food chain due to the increasing numbers of mergers in industries such as livestock, grain, rail, and biotechnology.

During this period of enormous transformation in the agriculture industry, disparity in market power between family farmers and large conglomerates all too often leaves the individual farmer with little choice regarding who will buy their products and under what terms.

Many commodities, including pork, beef, poultry, and grains, have experienced significant degrees of concentration. In the pork industry, the top four processing firms control more than 60 percent of the total market, a number which will increase to more than 65 percent if the merger we are considering today is approved. On the beef side, the top four beef packers purchase about 80 percent of the Nation's cattle. Rather than buying on the open market, processors of farm commodities are relying more and more on contractual agreements with farmers, which bind the farmers to sell a specified amount of product for prices specified by the processors.

In many cases, there is no longer a significant open market to which farmers and ranchers can turn. These contractual arrangements damage the independence of family farmers, leaving them little choice regarding what to grow and the terms on which to sell their products.

For example, from 1993 to 2001, the share of total hogs sold through contractual arrangements increased from 10 percent to 72 percent. Consequently, sales and purchases through the traditional spot markets have dwindled to 28 percent total sales. We should be concerned that the same trend may occur in the dairy industry. Similar concentration in the dairy industry has already occurred to some extent, particularly in the fluid milk market in the Northeast. Thankfully, this is not yet the case in the Upper Midwest. Dairy producers in our region continue to enjoy a significant degree of competition for their milk supplies.

But we must do all we can to make sure that it stays that way. It is only through proper and aggressive enforcement of current antitrust laws, both at the Department of Justice and the FTC, and also by vigilant enforcement of the Packers and Stockyards Act at the Department of Agriculture, that we can be certain that producers and consumers alike benefit from open and fair markets.

We should also consider whether the Department of Agriculture should be given a greater role in advising the Justice Department and the FTC in evaluating the competitive effects of agriculture mergers. We must not allow abuse practices or disparities in bargaining power between farmers and agribusiness to disrupt farmers' equal access to the market or farmers' ability to receive fair prices for their products.

I am pleased that we will hear today from this panel of experts. I would like particularly to thank Will Hughes of the Wisconsin Department of Agriculture, Trade and Consumer Protection, for being here this afternoon. We appreciate you making arrangements to testify under such a short time frame. And we welcome all our

witnesses this afternoon and look forward to hearing your thoughts on this important and timely issue.

Thank you, Mr. Chairman.

Chairman DEWINE. Senator Kohl, thank you very much.

We are delighted to have today as our first witness Hon. Tim Johnson, U.S. Senator from South Dakota. Senator Johnson, thank you for joining us, and go right ahead.

STATEMENT OF HON. TIM JOHNSON, A U.S. SENATOR FROM THE STATE OF SOUTH DAKOTA

Senator JOHNSON. Well, thank you, Chairman DeWine and Senator Kohl. I appreciate you allowing me to testify at today's hearing on agricultural market concentration, Smithfield's proposed acquisition of Farmland's Pork Division, and legislation I have sponsored with my colleague, Senator Grassley, to ban packer ownership of livestock.

On July 15, Smithfield Foods offered to purchase the Pork Division of the bankrupt cooperative, Farmland Industries. The purchase agreement is subject to court approval, and the Justice Department must ratify the acquisition as well.

Today, I join Senators Grassley and Harkin to call for an immediate and comprehensive review of this deal by the Department of Justice. The Antitrust Division of DOJ needs to carefully examine the possible negative consequences this buyout could cause for pork producers and consumers.

Smithfield made a host of promises in conjunction with the Farmland deal, including the pledge that the company will honor all production contracts with farmers and maintain slaughter capacity at all Farmland facilities.

Previous actions demonstrate that Smithfield is an opportunistic company whose number one job is to increase financial returns for its shareholders, and South Dakota workers and farmers have suffered the consequences.

On August 8 of 1997, Smithfield purchased the Dakota pork-processing facility in Huron, South Dakota. The plant employed 750 people, slaughtered around 7,000 hogs daily. It was Huron's largest employer and one of two South Dakota markets for slaughter-ready hogs. One day later, on August 9th, Smithfield shut down the Dakota pork plant, laid off the 750 South Dakotans who were employed there. The community of Huron has never fully recovered since.

In the matter of a single day, nearly a thousand South Dakota workers were laid off, an important rural community in South Dakota suffered a devastating economic blow, and thousands of South Dakota pork producers were left with only one market for their slaughter hogs, another facility owned by Smithfield in Sioux Falls, South Dakota.

Before Smithfield closed the Dakota pork plant in 1997, South Dakota had over 3,000 independent pork producers. Today there are about 1,600 pork producers remaining in my State. Market experts have forecast that if Smithfield is allowed to purchase Farmland, additional pork facilities could be subject to unilateral closure by the company.

I believe the Department of Justice will conclude that this sale would boost Smithfield's already mighty market power in South Dakota, Iowa, Nebraska, and Minnesota, reducing or even eliminating competition in several critical regional and local markets. Since 1981, Smithfield has acquired nearly 20 competitors, and the company is continually stalking others in hopes to expand market share and increase profits.

As the world's largest pork producer, Smithfield currently owns one out of every four pigs in the United States, a total of about 760,000 hogs. The addition of Farmland's 36,000 sows would put Smithfield close to 800,000 sows. Smithfield is also in negotiations currently to purchase Alliance Farms, which has 7,500 hogs in Illinois and 20,000 in Colorado. If the Alliance and Farmland purchases are approved, Smithfield's total ownership will be in the range of 825,000 hogs.

As the world's largest pork processors, Smithfield produces 60 percent of the pigs they slaughter. A merger with Farmland would give them direct control over 30 percent of the slaughter hog market in the entire United States. This market power would result in reduced competition and fewer independent pork producers.

While the Department of Justice must approve this deal before Smithfield can completely acquire Farmland's Pork Division, Smithfield market aggression is just another reminder that the Johnson-Grassley packer ban legislation, Senate bill 27, is, in fact, desperately needed. Congress and the administration both have a role to play in ensuring that we have more competition, not less, in agricultural markets. Indeed, current laws are often too antiquated to deal with the modern market tactics of meat packers and others. Additionally, Federal regulators have been slow to enforce the existing laws.

Our packer ban legislation would amend an 80-year-old law, the Packers and Stockyards Act, under the jurisdiction of USDA. Three years ago, when I first introduced legislation to ban packers from owning livestock, we were able to pass the packer ban twice last year through the United States Senate during consideration of the farm bill. Unfortunately, it was killed by the House of Representatives in conference committee.

The Johnson-Grassley bill gives independent producers a fair chance to compete. Our legislation would prevent packers, including Smithfield, from operating as a producer and result in a more competitive, open, and transparent market. In short, it is one modest step to ensure the free enterprise system still applies to livestock markets.

USDA says that packer concentration has increased 45 percent in the past 20 years. During this time, the food retailing and packing industries have amassed profits triple the rate of the general food inflation. In fact, cargo increased profits by 67 percent to 2001. Smithfield increased profits by 28 percent. And after Tyson bought out IBP, its profits tripled. As a result, we have a meat-food industry which is doing well at the expense of our farmers and ranchers because they have the economic power to influence markets in their favor. Independent livestock producers do not.

The issues of packer ownership in agricultural market concentration go to the very heart of what agriculture will look like in the

future. Will it be controlled by a handful of powerful firms where farmers and ranchers become, in effect, low-wage employees bearing all the risk but none of the gain in the market? Or will it be a future of independent family farmers and ranchers contributing to rural communities that are diverse and economically strong, independent producers who have the leverage to demand a decent price for their animals? These problems demand a comprehensive approach which includes the attention of the Judiciary Committee, Agriculture Committee, Department of Justice, and USDA.

Mr. Chairman, I close with the following recommendations:

One, that the Antitrust Division of the Department of Justice should scrutinize Smithfield's proposed purchase of Farmland's Pork Division and consider preventing it;

Two, Congress should enact the Johnson-Grassley packer ban legislation;

Three, Congress should consider legislation sponsored by my colleague Senator Enzi and me to prohibit captive supplies of market livestock;

Fourth, finally, Congress should consider legislation pushed by Senator Daschle to require USDA to review whether a proposed merger would have a negative effect on family farmers and rural communities and to increase penalties for antitrust violations.

Thank you, Chairman DeWine, Senator Kohl, for this opportunity to share my thoughts with you today.

Chairman DEWINE. Senator Johnson, thank you very much for a very provocative statement, and it gives us something to think about as we hear the testimony from the other witnesses. We appreciate it very, very much.

Senator JOHNSON. Thank you.

Senator KOHL. Thank you very much, Senator Johnson.

Chairman DEWINE. I would ask our other witnesses to come up. Senator Grassley had to attend a meeting at the White House. He asked me to put a statement into the record, which I will, as well as two letters, one from the Consumer Federation of America and one from Public Citizen. In addition, we have a statement from Senator Leahy. Without objection, all of these will now be made a part of the record.

I would ask all our witnesses now to please come up, and I will now introduce our witnesses.

Joe Sebring is the CEO of John Morrell, a subsidiary of Smithfield Foods. John Morrell is the leader in the pork packaging industry and is based out of Cincinnati. It is considered to be the oldest, continuously operating meat processor in the United States.

The next witness is Will Hughes, the administrator for the Division of Agricultural Development for the Wisconsin Department of Agriculture, Trade and Consumer Protection. His division has been given the task of assisting Wisconsin farmers in adapting to the growing demands of the agriculture marketplace.

Dr. Luther Tweeten is a retired professor at Ohio State University. He has authored several publications in the area of agriculture consolidation and has testified before this Subcommittee in the past.

Mr. Russ Kremer is the president of Missouri Farmers Union. He has been involved in pork production his entire life, and he brings to the Subcommittee his experience as an independent farmer.

Mr. Patrick Bell is a hog farmer from Kenansville, North Carolina. After graduating from the University of North Carolina, he worked in the banking industry for several years before returning to his family farm.

Finally, Mr. Michael Stumo is general counsel for the Organization for Competitive Markets, which is a nonprofit organization focusing on antitrust and competition issues in agriculture.

We will start on my left with Mr. Sebring. Mr. Sebring, would you like to start? We are going to have a 5-minute rule. We are going to stick to the 5-minute rule so that we can have ample opportunity for questions. When you see the yellow light, that means you have a minute left.

Mr. Sebring?

STATEMENT OF JOSEPH SEBRING, PRESIDENT, JOHN MORRELL, INC., CINCINNATI, OHIO

Mr. SEBRING. Thank you, Mr. Chairman. I would like to correct the record. The Dakota pork plant was closed before Smithfield took possession, and in South Dakota, there is already a ban on corporate farming. And in spite of that, the hog population has dwindled by 50 percent in the last about 5 years.

Thank you, Mr. Chairman, for the opportunity to share the view of Smithfield Foods about Federal policy for the meat-packing industry and the pending acquisition of Farmland Foods by Smithfield Foods.

I am Joe Sebring, president of John Morrell, an Ohio-based company that produces processed meats and fresh pork. Our industry is already subject to the Sherman Act, the Clayton Act, the Robinson-Patman Act, the Federal Trade Commission Act, State laws, the Uniform Commercial Code, and the Packers and Stockyards Act. There is no reason for more restrictions on our industry.

Smithfield has made a bid for certain assets of Farmland Foods. Farmland's creditors and bondholders recognized that the Smithfield transaction would provide the greatest opportunity to generate the highest available value to creditors, bondholders, and the people of Farmland Foods.

Over $1.4 billion in aggregate claims have been filed against Farmland Industries for more than 20,000 farmers and 141,000 small businesses. For example, in South Dakota, 291 bondholders have claims of nearly $28 million, and there are more than 2,200 creditors who are owed about $84 million. There are more than 4,200 Iowan bondholders with claims against Farmland exceeding $37 million. The 4,257 Iowan creditors of Farmland are owed more than $92 million. They have waited long enough.

Smithfield will honor all current Farmland Foods hog production contracts, 6,100 employees of the Farmland Foods will keep their jobs, and the Farmland Foods facilities will remain open. The UFCW will continue to be recognized at the unionized plants, and Smithfield has offered to assume the Farmland Foods pension plan. Farmland Foods headquarters will remain in Kansas City, and Smithfield will preserve the Farmland brand.

Our customers demand consistent meat quality, ready and predictable supplies, and a fair price. They want their meat to be consistently lean every time. Fast-food retailers and grocers have imposed strict requirements on packers. Vertical coordination is the best way to meet these requirements. It is a pull-through model. We are pulled along by the demands of our customers and have met those demands by maintaining some level of vertical coordination. The slightest interruption in supply is unacceptable to our customers. That means that forward contracting with hog producers must be balanced by company-owned animals in order to assure consistent supplies.

During the last 2 years, John Morrell has bought 33 to 45 percent of the hogs available on the open market, and Smithfield itself sells 25 to 30 percent of the hogs sold on the open market.

Consumers have demanded leaner pork, so we have developed our lean generation pork. We can provide this new leaner pork because we control the way that hogs are raised. Without some level of coordination among hog producers and meat packers, we will be out of the business of producing consistently lean pork.

There are other benefits to a coordinated system of production. Our on-farm biosecurity procedures and data are completely within our control. A reasonable level of vertical coordination allows us to ensure delivery of safe meat products to comply with EPA standards and other regulations and to guard against tampering by terrorists. Our system enables us to keep our products traceable and limits the number of people who have access to the products all along the chain of supply. It is not just a matter of economics. It is also a matter of homeland security.

Forward contracting allows farmers to plan for the future. Lenders now routinely demand that farmers produce contracts before providing them with financing. In our system, both company-owned farms and contract growers have the benefit of a predictable place to sell their animals, regardless of any spikes or downturns in the market prices.

Family farmers are our fellow hog producers and our suppliers. John Morrell purchased more than half of its hogs from non-contract farmers in the last fiscal year. That is almost 4 million hogs. We don't agree that barring our company from raising hogs will help independent hog producers. It plainly will harm them.

We have built our business model in response to the non-negotiable demands of the consumer and the marketplace. With a flexibility achieved through a reasonable level of vertical coordination, we maintain low and stable prices for consumers by owning and contracting for hogs. We ask only that our company not be barred from owning or contracting for some of our hogs as we strive to stay competitive. We honor family farmers, and we ask you to keep in mind that the coordination of our system serves the food security effort and to look at the economic data and consider what a ban on packer ownership would do to our industry.

Thank you very much.

[The prepared statement of Mr. Sebring appears as a submission for the record.]

Chairman DEWINE. Mr. Hughes?

STATEMENT OF WILL HUGHES, ADMINISTRATOR, DIVISION OF AGRICULTURAL DEVELOPMENT, WISCONSIN DEPARTMENT OF AGRICULTURE, TRADE AND CONSUMER PROTECTION, MADISON, WISCONSIN

Mr. HUGHES. Thank you, Chairman DeWine and Senator Kohl, for the opportunity to share today some perspectives from a State government as it relates to concentration in food and agriculture. On behalf of the State and its 77,000 producers, I would especially like to thank Senator Kohl for his excellent leadership and representation of Wisconsin agriculture and for his invitation to us to speak about these issues related to concentration and its implications for producers.

My testimony today is going to talk primarily about policy and make a few policy recommendations that we hope Congress would consider as it establishes both the national agricultural and antitrust policy that I agree with Senator Johnson needs to be comprehensive and coordinated.

Let me first give you just a snippet of information about our agency and its uniqueness. We are called the Agriculture, Trade and Consumer Protection agency because we have what is called the "Little FTC Act" in Wisconsin, which gives us sweeping powers to protect consumers and competition in the areas of fair business trade practices. And I want to give you a few examples of where we have had some relevant activities that deal with concentration in markets and uneven market power.

We have established rules in the vegetable processing industry in dealing with contracts between the producers and the processors. We have had major enforcement actions against price discrimination in milk procurement where one producer is treated differently in pricing relative to another producer without any basis in cost differences and so on. We have had a major investigation into the business practices associated with the National Cheese Exchange, using the power of that Little FTC Act.

In each of these cases, Wisconsin had to act on its own, and we, quite frankly, did not get coordinating help from the Federal Government. And it is not only difficult for farmers to address these issues on their own or through their organizations, but it is also difficult for individual States. And as concentration increases rapidly from the retail sector back through the supply chain, the issues do not go away.

We wanted to express to you the importance of what we think is evidence of having a competitive market in the dairy industry. Wisconsin is blessed with having a fairly high number or large number of buyers competing for milk produced by the 16,500 Wisconsin dairy producers. We have a graph in our testimony that compares the Western region of the United States with the Upper Midwest region, and it is a mechanism of pricing that is reported by USDA that shows that, on average, over the last 5 years, that price difference has been $1.03 between the Midwest and the Western region. And we believe that that illustrates the value of preserving competition in agricultural markets.

I can give you a specific example: A producer in Wisconsin at a meeting a few years ago laid out a chart for a very large audience to show that he had 13 competing buyers for his milk in an area

of northeast Wisconsin, had every pay price pegged all the way down the line—open, transparent information that that producer had with choices. That is the value of preserving competition.

Wisconsin Department of Ag's priority is to revitalize and grow the dairy industry with diverse farm production systems, and that includes, if we do that, attracting a good climate for producing milk as well as a good climate for buying milk. And included in that is an active and favorable climate for dairy producer cooperatives to thrive in the business environment.

This process gets difficult as concentration increases, and we would like to bolster that heritage of producer-owned organizations, and to do that we think that there are a few recommendations, policy recommendations, that you should consider.

One is to improve and tighten coordination on antitrust and concentration issues not only between the U.S. Department of Justice and USDA but also among States. An active working group in that area would be very important.

We would also like to see, given the tremendous activity and issues surrounding concentration, that there be increased funding committed to support agricultural concentration research and antitrust issues, not only to have a better idea of what is going on and the impacts of what is going on, but also to help formulate new policy frameworks to address these issues. In the 1960's and 1970's, there was a lot of research in the industrial organization area concerning the food sector. Go back in the early part of the century, the same. There is a dearth of it now, and it needs, given what is going on, to be improved.

We would like to see, because we believe innovation and new business formation creates a healthy marketplace for both producers and consumers, increased programs and funding for the development of producer-owned and value-added businesses.

We would like to see strengthening the competition in the meat industry by removing the prohibition on interstate meat shipments from State-inspected—it is actually meat and poultry product plants. And we have 300 of those in Wisconsin, and there are some very innovative companies in that mix that the U.S. marketplace as well as the Wisconsin economy would enjoy the benefits of.

We would like to see that producers have continued ability to bargain for fair prices and fair terms of trade and that the transparency of pricing for agricultural commodities continue to be emphasized and improved upon from what it is now.

Again, our agency goes on the idea that putting our policies and rules, establishing standards that govern fair business practices, is what is needed, gets the public more involved, puts more light on the subject, and that should be part of the policy recommendations that you consider.

Thank you for the opportunity to share these perspectives.

[The prepared statement of Mr. Hughes appears as a submission for the record.]

Chairman DEWINE. Thank you, Mr. Hughes.

Dr. Tweeten?

STATEMENT OF LUTHER TWEETEN, AGRICULTURE CONSULTANT, COLUMBUS, OHIO

Mr. TWEETEN. First of all, I wish to thank Chairman DeWine and Senator Kohl for the opportunity to be here.

I regard the Smithfield Foods acquisition of Farmland Foods to be a positive development for the food industry, including for producers and consumers. There will be short-and long-run effects. As has already been pointed out here, the short-run effect is pretty much status quo. Smithfield has agreed to even retain the labor union, the workers, the pay rates, the brand name of Farmland, the management, and so forth. So it will be a kind of status quo in the short term. However, knowing Smithfield, they don't let the grass grow under their feet. They change in response to changing conditions.

Over time, there is likely to be larger plants serving larger areas. There is likely to be an expansion of production and marketing contracts. And, of course, there is going to be concentration.

Now, the share of the market held by Smithfield, according to the data I have, is about 20 percent. That will go up to 27 percent. The principal benefit of this merger is that you are absorbing Farmland, which is a small, not financially viable company that does not do a lot of service for farmers, for consumers, for competition, absorbing it by a company that is financially viable, dynamic, innovative. That is going to help competition. It is going to be better for the parties involved, including the creditors.

One of the concerns is about concentration. This is not going to do a lot to concentration. But what is the impact of concentration on producers and consumers? We have looked at this at Ohio State in terms of marketing margins. There are two effects here of concern. One of those is with concentration, larger firms, economies of size. That reduces cost of production. If they are passed on to farmers and consumers, it means lower marketing margins.

On the other hand, you have increasing market power. If that effect dominates, then you are going to have larger marketing margins in either higher prices to consumers, lower prices to farmers, or both.

What we find for the hog industry, the beef industry, and the turkey industry is that the net effect of concentration is lower marketing margins. Now, that is the good news.

The bad news is that the benefits are passed to consumers, not to producers. That is exactly what economic theory would tell you. Economic theory tells you and empirical data indicate that processors pay farmers what it takes to get the product delivered. In the longer term, this means covering the full cost of production on adequate size, commercial, well-managed farms. We find empirical evidence for that. And it does not matter whether you are dealing with a monopolist, a monopsonist, a competitive firm, a cooperative, or whatever. Nobody is going to give farmers gifts in terms of prices. They are going to have to earn it. They are going to have to compete. And so they are all going to operate on the supply curve.

Now, the question is: Where on the supply curve? The conventional wisdom is that because of imperfect competition, the imperfect firm will pay less, operate lower on the curve, take lesser

quantity at a lower price. However, that is not the right thinking. What, in fact, happens is that oligopolistic firms, which dominate the food processing and marketing industry, advertise and innovative massively. A consequence of that is that we sell an awful lot of food. In fact, they are so good at selling food that nearly two-thirds of Americans are overweight, and about half of those overweight people are obese.

So what I am saying is that farmers operate higher on their supply curve, higher price, higher quantity, because of imperfect competition in the agribusiness sector.

All right. My time is running out here, so let me close with a couple of recommendations.

First of all, I do find merit in this acquisition. There is certainly a basis for moving forward with it.

The second thing I want to point out is that it would be highly desirable to have greater transparency in markets, in the hog as well as other enterprises in agriculture. I know that is not easy to do in the case of marketing and production contracts because those contracts often differ from one case to another. But I think what we need to do is have the people from the processing industries, producers, academics, sit down and try to work out some templates that will allow them to report better and give people a greater opportunity to compare outcomes, to compare returns among farmers, States, industries, and so forth.

Thank you.

[The prepared statement of Mr. Tweeten appears as a submission for the record.]

Chairman DEWINE. Doctor, thank you very much.

Mr. Kremer?

STATEMENT OF RUSS KREMER, PRESIDENT, MISSOURI FARMERS UNION, JEFFERSON CITY, MISSOURI, ON BEHALF OF THE NATIONAL FARMERS UNION

Mr. KREMER. Yes, thank you, Chairman DeWine and Ranking Member Kohl, for the opportunity to testify before the Subcommittee on agricultural concentration and the proposed sale of Farmland Foods pork division to Smithfield Foods. I ask that my full statement be submitted into the record.

Chairman DEWINE. It will be made a part of the record. Thank you very much.

Mr. KREMER. I am Russ Kremer, president of the Missouri Farmers Union, and I am here today to testify on behalf of the National Farmers Union.

I have been involved in independent pork production since I was a child in a count that, for many years, led our State in the number of independent pork operations. However, during the past year, we have seen our marketing opportunities and, therefore, our profit opportunities dwindle dramatically. Market choices during that time in my area have declined from five to two. The potential acquisition of Farmland by Smithfield Foods threatens to reduce that number to one. Without competitive bids and fair market prices, another large exodus of family farmers from the pork industry is likely to occur. Many of our local communities that once enjoyed a sustained economy due to the circulation of revenue from inde-

pendent pork farms and community-based businesses will continue to experience serious decimation.

The trend toward horizontal and vertical integration in the agriculture and food sectors does not allow independent producers to succeed without protection from unfair and anti-competitive practices. The loss of our Nation's largest farmer-owned cooperative is not only devastating to America's independent agricultural producers, but also furthers the goal of Smithfield Foods to gain greater control of the pork production and processing sector. If this sale is approved by the U.S. Bankruptcy Court and the Department of Justice, Smithfield Foods will control 27 percent of the pork processing industry. The top four processing firms—Smithfield, ConAgra, Tyson/IBP, and Cargill—will now control 60 percent of the market, up from the 37-percent level in 1987.

Currently, Smithfield raises 12 million of the 20 million hogs slaughtered in their processing plants on a yearly basis. The addition of Farmland's 36,000 sows will increase the Smithfield's sow inventory to approximately 800,000. This is 3 times the number of sows owned by the next largest pork producer—Premium Standard Farms.

In 1994, the Smithfield sow inventory totaled approximately 65,000. In less than 10 years, this single company has managed to increase its ownership of sows 12-fold through acquisitions and mergers such as the one being discussed today. To allow this proposal to be approved prior to Congress conducting a thorough review to ensure antitrust laws are adequate would be like shutting the gate after all the pigs get out.

I believe producers in my State and across the country will be further faced with lack of buyers and a competitive price for their hogs as a result of this proposed acquisition. Smithfield officials have indicated that if the proposal is approved, they would continue to operate and maintain production levels at all Farmland plants. What has been left unsaid is the fate of the other plants purchased by Smithfield through previous acquisitions and mergers that may now be determined inefficient. Employees of these plants will be put out of jobs, local producers will be left with fewer marketing opportunities, and the communities will be responsible to clean up the mess left behind.

Although contract production is often touted as a viable opportunity and risk management tool for farmers, without contractor competition in the region the contractee has little bargaining power when it is time to renew that 5- or 7-year contract. That farmer often finds himself in a "take it or leave it" position.

Concentration of the agriculture and retail food sectors has, in many instances, discouraged the growth and development of smaller, farmer-owned, value-added cooperatives. As president of the Ozark Mountain Pork Cooperative, a new-generation cooperative that processes and markets pork from member-owned hogs, I myself have witnessed many challenges to accessing the marketplace because of this huge market concentration and power. Large conglomerates often have tight control of brokers and retail distributors.

The loss of family farms and other independently owned businesses is not inevitable. The National Farmers Union believes

there are a number of reforms that can originate within this Subcommittee to ensure fairness, transparency, protection, and bargaining rights for producers, which would restore and enhance competition for agricultural markets. A few of these I may list at this time:

Number one, we feel that Congress should expand the role of USDA to initiate the review of proposed mergers in the agricultural sector and require an economic impact statement be provided, detailing the impact of a proposed merger on farmers and ranchers prior to approval.

We feel that Congress should require USDA to collect and publish concentration information.

We support the implementation of a temporary moratorium on large agricultural mergers. The moratorium is necessary to provide Congress with time to review current law and strengthen its appropriate time to restore market competition for producers and consumers.

We also believe a specific level of concentration should be established, a so-called threshold level, that triggers a presumption of a violation of antitrust law.

I have also highlighted more of these reforms in my written testimony for the record.

Thank you, Mr. Chairman, for the opportunity to testify today and for holding this important hearing. We look forward to working with you in this Subcommittee and the entire Congress to strengthen antitrust laws and foster a transparency and fair marketplace for all producers. I welcome the opportunity to answer any questions the Subcommittee members may have.

[The prepared statement of Mr. Kremer appears as a submission for the record.]

Chairman DEWINE. Mr. Kremer, thank you very much.

Mr. Bell?

STATEMENT OF PATRICK BELL, FARMER, KENANSVILLE, NORTH CAROLINA

Mr. BELL. Thank you, Mr. Chairman. I appreciate the opportunity to come talk with your Committee today.

My name is Patrick Bell, and I am a contract hog farmer from North Carolina. I came to give you my perspective as someone who is on the farm every day because I think it is important for this Committee to hear from someone who is actually out there every day doing the job.

I have a hog farm that is under contract with Murphy Farms, which is part of Smithfield Foods. I would like to begin my testimony by telling the Committee a little about my background. I grew up in a small town named Kenansville, in eastern North Carolina, a lot like Mayberry. It is a small, tight-knit community of about 900 people, where agriculture was the most important industry and basically the only industry.

I came from a farming family, but when I was ready to begin my working life, it really was not an option for me to work full-time on my family farm, and certainly not an opportunity for me to get my own farm. I went to college and graduated from the University of North Carolina in Chapel Hill. I went into the banking industry,

worked for banks for about 10 years as a branch manager and commercial loan officer.

In 1992, I turned 30 years old, and my father celebrated his 60th birthday that same year. He sat me down and he gave me a choice. He said, “Son, you are the only child. You have got a choice. You can continue in banking and commit yourself to a life outside of farming, or you can return home to your small town. We have very little industry or opportunity beyond the farm gate, but if you will come back home, you can take over our contract hog farming operation.”

It was a tough decision for me to make, but I decided to return home and go into business with my father. That was 9 years ago, and we have had a few struggles. But since then, we have expanded our operation to almost twice its original size. Now our farm earns enough money for me to support my family, myself, my mother and father, and that gives me a lot of satisfaction.

In hindsight, the decision to return home was one of the best decisions I ever made because it allowed me to live in the small town I grew up in and that I loved; it allowed me to be in business with my father, who I am very close to and that I love; and it allowed me to provide for my family—we just had a set of twins that are 4 months old—and build some long-term security.

My family and I have a deep, emotional attachment to farming. But when I made the decision to come back home and leave banking, I always knew it was a business decision. When I decided to return home to look at the contract agreement that was with Murphy Farms at the time, I had three main questions:

Number one, if I invest my savings in this farm, will it be a good investment that has good, solid, consistent cash flow?

Number two, does the company that I will contract with have the ability to pay my contract, and can I count on them to pay the contract?

And, number three, will this investment provide a stable income and reliable profit for me and my family over the long term?

Well, after being in the hog business for 15 years under contract, first with my father and then with me and my father, I am happy to say the answer to all three questions is absolutely yes.

Finally, I think it is important for this Committee to understand that the North Carolina hog business is not owned by some nameless, faceless, monolithic corporation or group of people. In my State, and in most other hog-producing States they operate in, the hog business is composed of a lot of small family farmers like me. In fact, small farmers like me grow 80 percent of Smithfield Foods hogs in North Carolina. The contracts we have make it possible for us to stay on our family farm or come back home, as I did, and provide a living for our family by growing these hogs under contract with Smithfield.

When I signed that contract, I not only knew that I was going to get a fair price, but I knew what the future was going to hold for my family. I would not have to be worried about market ups and downs. I know that Smithfield bears the costs and supplies the expertise for my veterinary services, provides technical assistance for compliance with environmental and safety regulations, all of which they fully expect me to comply with. In return, I get—and

this is an important thing as an ex-banker. I get to tell the people I do business with in my small town that I have a stable business. I get to tell the local banker, which is very important, the local hardware store, and everyone else, they can extend me credit because I will be able to pay it because of this contract.

When I was a banker, I had the unhappy duty of turning down some good farmers for loans—they were good people and good farmers—because they did not have contracts for their hogs. They were independents. The price of hogs went to 8 and 10 cents a pound at one time. Not sustainable as an independent. It was a hard thing to do, but I am just grateful that my business is not subject to that kind of uncertainty.

One of the things that is not in my written testimony that I would like to interject here quickly, Mr. Chairman, if you will, I have heard some conversation about the packer ban as I came in here today, and I am not privy to all the details of the packer ban. I do not know much about it except what I have read. But I do know this: In North Carolina, we farm under contract, mostly contract farming, and without the packer being able to own the hogs in North Carolina, I would be out of business. And most of the people I know, the 2,300 contract growers in our State are not going to run down to the local bank and borrow money to put pigs in the houses and buy feed, number one, because they are not willing to take that risk; and, number two, the bank is not going to loan them the money, not in North Carolina.

The legislation I assume is national legislation. The last thing is I do not know the details of the Smithfield/Farmland acquisition. I know nothing about it, never really even heard of Farmland. But I am sure of one thing. Hog farmers who have contracts with Farmland should be very glad that Smithfield will honor those contracts. I know from experience they are dealing with honorable people. They will get a fair price. They will be able to enjoy stability in their business, and it will help be able to keep their family farms alive and thriving.

Thank you for the opportunity to address your Committee.

[The prepared statement of Mr. Bell appears as a submission for the record.]

Chairman DEWINE. Mr. Bell, thank you very much.

Mr. Stumo?

STATEMENT OF MICHAEL C. STUMO, GENERAL COUNSEL, ORGANIZATION FOR COMPETITIVE MARKETS, WINSTEAD, CONNECTICUT

Mr. STUMO. Thank you, Chairman DeWine, Senator Kohl, for allowing me to testify. As well as being general counsel for Organization for Competitive Markets, I am a former hog producer and hog buyer from Iowa.

The reason that we do not want—that we want to intervene and allow the market to work and keep the market working at this point is so that we do not have the lack of choices that are in North Carolina where the farmers in Iowa, Minnesota, South Dakota, Nebraska, and Wisconsin have to ask Smithfield whether they want to produce or there is no other option. This merger—this acquisition, rather, of two of the top—the top pork processing company in

the country of another top-tier processor is bad for not only producers but consumers. That is why Consumer Federation of America opposes it, that is why Public Citizen opposes it, because we have seen in recent years not only the downward trend for hogs and hog prices and hog farm profitability, which everyone agrees to, but also in the last 10 years increasing gross profit margins by packers and retailers, which is showing us that they are less efficient or they are exercising market power to the detriment of producers and consumers. That is why producers and consumers are united on this issue.

The big problem with this merger is that Smithfield—or acquisition, excuse me, is Smithfield is gaining increased power in the price-setting region of the U.S. hog market. The Iowa-southern Minnesota price is the gold standard. It sets the price for the country. This is different than a merger occurring in another area of the country and increased concentration there, because the Iowa-southern Minnesota prices establish first the transitions to the Western corn belt market price, which is Iowa, southern Minnesota, Nebraska, and South Dakota, primarily. And all the contracts that are formulated from an open market price as well as other open market transactions elsewhere in the country are derived from the first determined Iowa-southern Minnesota price. So this is like BP acquiring ARCO and the concern about the price-setting mechanism in oil and gas of Cushing, Oklahoma, that they would be able to control and affect that price-setting mechanism which affects oil and gas prices elsewhere in the industry. This is the same thing.

So we have Smithfield Sioux Falls and Sioux City plants, and we have Farmland's Crete, Nebraska, and Denison, Iowa, plants. We have about a 250-mile draw or procurement area, significant overlaps here. So what we are doing is taking out a major buyer in the price-setting region of the country with these significant overlap areas.

Now, the recent estimates by folks like Glenn Grimes and Ron Planey, University of Missouri, that follow the hog industry are that 87 percent of the hog industry is vertically integrated. That includes packer-owned and contracted, non-packer-owned contracts. Ninety percent of the contracts that are not packer-owned pigs are a formula market based in some way off the open market price. So there is not only a tremendous incentive always for the packer to reduce open market price to save money on the hogs he is actually purchasing, but now, with 90 percent of the contracts formulated on this open market, if the price goes up because of supply and demand conditions by a couple of bucks, all of a sudden that telescopes and directly affects and makes far more expensive all those hogs that are pegged to the open market. So it is a different scenario, tremendous incentive to push price down.

There is no reasonable argument that hog prices will go up as a result of this transaction. The reasonable argument is that hog prices will go down. If we assume a $1 decrease in live hog price on 270-pound hogs, 375,000 pigs per day, that is $1 million per day lost to the U.S. hog production industry; 250 kill days, that is $250 million per year lost to U.S. producers, gains to Smithfield and the other packers. Consumers do not see it because there is no relation-

ship between farm gate price and consumer price. Pure market power scenario. There is no evidence to the contrary.

Further, Farmland is not a failing firm in the pork business. This is a Chapter 11 reorganization. They sold off a fertilizer business, grains, and beef. The pork business is a profitable business. Third-quarter results released a week ago Monday, $9 million profit. Annualized, that is $36 million. That is the seventh consecutive quarter in which Farmland pork profits have been greater than year prior. Everyone assumed that Farmland would reorganize around pork, but we have Smithfield desiring more market power, the creditors Committee desiring more payoff, but it is contrary to the public interest and fair open markets. So producers can make money, not go on a taxpayer dole, and they can stay in business.

We need competitive markets for this entrepreneurial industry. Thus, I urge the Congress and the DOJ to scrutinize and block this merger. We cannot have one buyer and begging Smithfield to get into business all over the country.

Thank you.

[The prepared statement of Mr. Stumo appears as a submission for the record.]

Chairman DEWINE. Well, let me thank our panel. We will start with questions. We are scheduled to have two votes at 5 o'clock, and the Senate is rather unpredictable. So we will see if that actually happens or not. If it does happen, we will have to stop, and because there are two votes it will take a while. But we will proceed with questions until that happens.

Let me ask any member of the panel who would like to respond. The spot market or cash market has now been decreasing. I do not know what the number is. I have heard it is down to possibly 10, 12, 13 percent of the market. What implication does that have if that continues to decrease? What significance does that have? Does that matter?

Mr. TWEETEN. I would like to respond.

Chairman DEWINE. Dr. Tweeten has already indicated in his written testimony that maybe it is not that important, but go ahead, Doctor. We will start with you, and then we will see if anybody else disagrees.

Mr. TWEETEN. Well, I think one of the myths about markets is that you have to have a cash market to have competitive pricing and output. Contracts also have to recognize markets. Again, I go back to what I said before, and that is, if you do not pay farmers enough to cover their costs over the long period of time, they are not going to produce. And that means that if you are under a contract system or a cash system, you are still going to have to respect supply and demand.

Agriculture is unique in that it has a lot of cash markets. There are lot of industries in this country, such as automobiles and so forth, that have almost no cash market. Parts suppliers, for example, there is very little cash market. It is almost all in a contract basis. But supply and demand still rule in those industries.

Mr. BELL. Mr. Chairman, if I may interject something?

Chairman DEWINE. Mr. Bell, go ahead.

Mr. BELL. As a contract grower, we have been in the pig business under contract for 15 years, and over that period of time, in the

last 5 years we have gotten, I think, four or five increases in what we are paid.

During the worst hog market, I guess in U.S. history, when the price was 8 cents per pound a few years ago, a lot of people used up the equity they built up over generations in their farm trying to stay afloat through independents, that is the best year I had in the hog business. Best year I ever had because I always get paid a consistent, steady price.

Chairman DEWINE. Mr. Kremer?

Mr. KREMER. Yes, as a participant in the spot market system, it has a devastating effect. It is interesting to note that as these large vertical integrators talk about building plants, they talk about buying from 13 to 20 percent off the open market. We are the residual suppliers, and it is kind of like if they need our hogs, they will bid them up somewhat. But most of the time they do not need our hogs and so the market has continued to go down, and so it certainly puts strain on us.

But the other thing, too, is that the spot market does, you know, drive the prices, for instance, when it comes time for contract deals, et cetera. And so as larger integrators concentrate more and the spot market becomes less, it shoves the price down and, therefore, it affects everyone across the board in a negative way as far as producers.

Chairman DEWINE. Mr. Stumo?

Mr. STUMO. The 87-percent vertical, of course, leaves 13-percent theoretical open market. The experts that advise us, the ag economists, industrial organization specialists, believe that 3 to 5 percent of the actual hogs traded, those in the Iowa-southern Minnesota market, actually set the price for virtually all the other hogs.

It is a fundamental tenet of industrial organization that when you have a few dominant firms interacting in a high-volume market, that is a problem because there are only a few dominant firms. However, if they interact in a very thin market, the ability for them to push price down or manipulate price downward is exponentially increased.

Chairman DEWINE. Mr. Sebring?

Mr. SEBRING. Senator, in the morning, we look and see what the demand is for pork for our business. What do our customers need? How many hogs do we need to run the plant efficiently? And if we need hogs that day, if there is a demand for pork, we go out and we buy the hogs that we need to fill our kill and to fill orders. And if there is a demand for that product, we bid up for those hogs and we bid up for those hogs and we bid up for those hogs until we get the number we need.

If, however, our customers slow down on the sale of pork and sell beef or sell chicken and they back off on the demand, yes, the market can go down. But that is the dynamics of the free market. And I do not know what percentage is bought every day, but I can tell you that is how we operate. When we need pork, we bid the price up. There is no other packer on earth that wants pork prices higher than Smithfield Foods.

Chairman DEWINE. Mr. Sebring, how much of your business do you want to be on long-term contract?

Mr. SEBRING. We are comfortable right now with—right now our contracts in corporate hogs are less than 50 percent. We do not have a problem buying hogs on the open market at 50 percent or more, as long as they are available.

Chairman DEWINE. But I would assume that there is some point that you do not want a contract above, isn't there?

Mr. SEBRING. I am sorry?

Chairman DEWINE. I would assume that there is some point you do not want a contract above. I mean, you would not want to lock yourself in—I do not know your business, but I would assume you would not want to lock yourself in at 100 percent of—

Mr. SEBRING. No, we do not.

Chairman DEWINE. You have got to have some flexibility in there. You cannot guess the market.

Mr. SEBRING. Absolutely. We want to be able to go to the open market every day.

Chairman DEWINE. Yes.

Mr. SEBRING. But if that open market continues to shrink—and I am not talking about how many people are buying on the market, but just literally hogs being available, then that is when we turn to contractors and to our own farms to try and produce and have enough hogs to fill our plants. Our plants will not run without the hogs.

Chairman DEWINE. Okay. We are going to stop at this point. We are into a roll call vote, and we will be back when we can get back. You can go right ahead.

Senator Kohl is going to ask a question. When Senator Kohl is done asking questions, we will stop. I am going to leave and go vote.

Senator KOHL. Thank you, Mr. Chairman.

Mr. Hughes, during much of the year 2003, Wisconsin dairy producers suffered through extremely low milk prices. Congress created a new dairy income assistance program during this time as part of the farm bill to help producers during periods of depressed prices. This program has been helpful, but obviously it is not the entire solution to the problems.

Mr. Hughes, can you give the Subcommittee your impression on the status of the dairy industry in Wisconsin? Specifically, how do issues related to concentration and consolidation affect the dairy industry? What impact does increased concentration among dairy cooperatives have on the ability of Wisconsin dairy producers to make a living? And, in your opinion, what are some of the things that we can do about this problem?

Mr. HUGHES. Okay. Thank you, Senator Kohl.

The situation in the dairy industry in Wisconsin is it is very challenged, as you know. We liken it to somewhat like in the automobile industry in the 1970's in Detroit. But the recent 20-month or so down cycle is more of a problem of supply and demand imbalance caused somewhat by import increases, particularly in cheese and milk protein concentrate. Also, the softness in the economy has really affected demand for dairy products. And the milk payments, the milk income loss payments have been the life saver in many respects in the dairy industry in Wisconsin.

The concentration issue has a long-term effect in dairy. It is hard to measure it day by day, but every year we see in recent years a major acceleration in consolidation both within the retail—excuse me, the fluid milk processing area as well as in the dairy cooperative arena. And as I stated earlier in my testimony, the best thing that a farmer in Wisconsin or any dairy farmer anywhere or any producer can have is a number of competing buyers for their product.

I like to say that once I see in a market less than four competing buyers for a product, I get very concerned. And I think it is fair to say that the movers and shakers in the dairy industry do not—and it is a different industry. You cannot liken it to vegetable processing or meat processing, but they do not want to see the kind of vertical integration and concentration that is occurring in poultry, hogs, and so on.

But the tendencies are there, and it does not have to go that way, but it well could. And I think the thing that is important to do about this—and in Wisconsin, it is somewhat of a structural problem because of the competition from the West Coast. But I think we need to do whatever we can in State and Federal programs to keep encouraging producer ownership and vital dairy producer cooperatives and have multiple buyers acting in the marketplace for producer milk. I think that creates innovation and strengthens the industry and gives consumers better results.

I am not sure that you can legislate or regulate the farm share of the retail dollar which gets discussed in lots of sessions. It is a very complicated subject why the retail margins have increased. There is lots of value-adding, ranging from advertising and promotion merchandising activities to just the degree of product diversity that is adding to that market basket cost. And the key thing there is to make sure that the farm level prices are not being depressed by that concentrating nature in the industry.

And I think we need to have a strong proactive antitrust approach that ensures that that does not happen, and that needs to be coordinated with ag policy.

Senator KOHL. I thank you, Mr. Hughes.

We will stand in recess now until Chairman DeWine returns. We will be in recess.

[Recess 5:12 p.m. to 5:49 p.m.]

Chairman DEWINE. Well, thank you very much. We will see how long we can go here go here without the Senate having its next vote.

Mr. Sebring and other processors seem to argue, I guess do argue that one of the reasons to have these contracts is to have the uniformity and higher-quality product. "Consistency," I guess, is one of the ways that they describe that.

Mr. Kremer, as an independent farmer, how do you respond to that? Do you think your product is an inferior product?

Mr. KREMER. Well, we are also, as I mentioned in my testimony, we have organized a value-added pork cooperative and have done a lot of studies and a lot of focus work and realize what consumers want are choices and they want competitive choices. And, of course, I also mentioned that it is very hard to break those types of barriers.

You know, I do not think it is as much—I mean, we can provide uniformity. In fact, the standards that the packers that are buying from us, you know, they have dictated that we have the lean kind of hogs, et cetera. And so I do disagree with that. I do say what the system is turning into, especially in the consolidation of the retail industry, is locking out some diversity. And that is what we face as we try to enter into some of the major retails systems, you know, the brokerage firms are basically consolidated, and it is hard to break that system. We cannot afford the $10,000 per product per year slotting fees that are required, and what happens, what we have seen in some of the largest retail settings, is that because the supply source is dominated by the larger conglomerates, actually the choices go down. They say this is our standard line of products.

And so I think that is an issue, and we know that consumers want choices, and we feel that smaller, more community-based entities such as ours are what consumers desire.

Mr. BELL. Mr. Chairman, can I add something to that, please?

Chairman DEWINE. Sure, Mr. Bell.

Mr. BELL. One of the advantages of being a contract farmer is that I would like to be concerned about genetics, about what needs to come to my farm and what does not need to come to my farm. I do not know a thing about genetics. We are really not concerned about genetics. All I am interested in is that I get paid per head per pig on my farm. And to me, that is the real advantage. I am not a genetics expert. I am not a feed mixture or nutritionist expert. All I know how to do is raise the pigs, and that is all I have to worry about. So, to me, under contract that is an advantage.

One thing that is sort of—I have been in a few meetings in the Midwest, pork meetings out there, and have met some people in the Midwest. And one thing that bothers me a little that I would like to say is that I have gotten comments such as, well, we are a family farm out here and you are not in North Carolina. My dad and I are the only ones who run our farm. I don't see how much more family we can get than that.

It is a matter of perception, in my mind. In North Carolina, the typical size farm is maybe 200 acres. That is a big farm in North Carolina. I went to the Midwest, and I was talking to this guy who was a farmer. I said, "Well, how big is your corn farm?" He was a corn farmer. He said, "We have got about 12,000 acres." That is a county in North Carolina. That is huge.

You know, when I was there, they said, "Well, you guys are nothing but tenant farmers in North Carolina." Well, calling a contract farmer a tenant farmer assumes two things:

Number one, that you do not understand the contract you have entered into, and I graduate from one of the top ten universities in this country in business school, and I guarantee you, I understand a contract. And the contract was a good choice for me to come home to do.

Number two, it assumes you were forced into that contract. And I would not have left the job I had, which was a pretty good job, to come home to a small town and enter into this contract situation. As a matter of fact, if it was a tenant farmer situation, it would be Smithfield that is a tenant on my farm because I own the

building and the land and they just have their pigs and feed out there.

If it was a tenant farmer situation and I am being forced into this and I am not intelligent enough to understand the contract I have entered, I would not be trying to buy a farm from my neighbor who is just down the road. As a matter of fact, we are going to meet about it Friday. He passed away and I am buying it from his wife.

So, to me, that argument does not hold much weight, but that is just my perspective.

Chairman DEWINE. Mr. Stumo?

Mr. STUMO. The contracts that I see in the Upper Midwest and the formula arrangements, the grade and yield premiums are the same as the open market transactions; thus, the incentive structure for quality is the same for both the contract and the open market. There is no distinction. And we are aware of no studies that have shown that there is some inherent quality benefit in the contracts or that there is one in practice versus the open market. So we see the same quality incentive structure both ways.

Chairman DEWINE. Mr. Sebring, you buy from the open market. You buy on contract. You buy both, correct?

Mr. SEBRING. Yes.

Chairman DEWINE. Difference in quality?

Mr. SEBRING. Yes.

Chairman DEWINE. But yet you are buying both?

Mr. SEBRING. Yes. Well, the contracted hogs have to meet certain quality standards, irrespective of, you know, the market conditions. And so those hogs are—we enter into contracts with the higher-quality hog producers, producers that have the genetics that we are interested in. Yes, they do get penalized if they bring us bad hogs, or they can get a premium if they bring us good hogs. But our goal is for them to bring us good hogs, and we expect them to earn some premiums.

But we also pay premiums for scheduling, having the hogs at our barns when we need them, and we pay different premiums for the type of feed and quality of the hogs up front. And then, yes, we pay them on a grade and yield basis also.

Chairman DEWINE. Does it matter to me as a consumer when I walk in the grocery store if I get a contract slice of one of your hogs or if I get a spot market hog? I am being a little sarcastic here, a little funny. But does it?

Mr. SEBRING. Today, more and more retailers and packers are trying to specialize, have various types of pork: the lean generation product we talked about, that is a very lean product; intramuscular lean and fat trim. But there is also the other side of that. We are developing prime pork programs that have marbling in the pork and the pork is literally fatter than it has been in many years. And there is a demand for that.

But, you know, for the most part, the consumer would not know on the average—today our hogs are all pretty good. They are all pretty lean. Our average lean-to-fat ratio is 54 today. Ten years ago it was 47, 48 percent lean, today 54 percent lean. So most of the hogs that are grown today are higher-quality hogs.

The contract is there so we know we are going to have enough hogs to run the plants.

Chairman DEWINE. You are getting your average up.

Mr. SEBRING. Yes. The quality, the average of the quality is getting better. And if you do not do that as a producer, you are not going to make it.

Chairman DEWINE. Mr. Stumo, Mr. Sebring wrote in his testimony that Smithfield and Farmland do not compete for the same hogs, but you have told us that there is overlaps between Smithfield and Farmland. Do you two want to explain the discrepancy in your—

Mr. STUMO. I disagree with Mr. Sebring. We have producers in our organization that sell to both, have them both bid on their hogs in Iowa and Nebraska.

Chairman DEWINE. Mr. Sebring?

Mr. SEBRING. There probably is some limited overlap, but for the most part, they are getting their hogs to fill their kill every day, and we are. So I would say there is enough hogs to go around between us.

Chairman DEWINE. As I listen to the testimony, it is not surprising I guess, I seem to get sort of two visions of farming, Mr. Kramer and Mr. Bell, of what farming should be, one contract farming—maybe that is the vision of the future—the other is independent farming. One is the vision of the future. You two want to comment on that? It just seems like I am looking at different worlds here.

Mr. BELL. I will be glad to comment on that, Mr. Chairman.

Chairman DEWINE. I get the impression, Mr. Bell, you did not think you could make it the other way.

Mr. BELL. It is not an impression. In North Carolina it is reality. In North Carolina, as a former banker, I saw situations where people would come into my bank, having used up their life savings and all the equity they build up over two generations to make it through a down market. The bank foreclosed on a lot of hog farms when prices are low. And I had seen that. I do not know if that is isolated to North Carolina or if that happens in the Midwest. They may not have any farmers go under if they are independent, but in North Carolina it happens.

As a banker looking at that, I was not willing to take that risk. I saw that happen to too many people I was also not willing to do what needed to be done nutrition wise, to be a nutritionist, to be a breeder, to be everything that I needed to be to be an independent, and a marketer for myself. Because of the contract, I was given all those things as part of my contract. Realistically, it is a matter of perception, Mr. Chairman, the perception that a family farm is 300 pigs or 200 pigs or 500 pigs, to me is—I grown more pigs than that, but by the same token a perception from someone in Iowa who has 12,000 acres of corn, to me that is not a family farm, that is a corporation.

Mr. KREMER. I have a different perspective, and I am not here to—I am not against contracting. People have the right to contract. But I have experiences with contract, most of them very, very bad experiences. As a young farmer advisor for 12 years, running a vocational agriculture program in an adult education program, it was

my job to oversee 300 farm families, and we always looked into the contract farming as an option, as a possible risk management tool, but we used it limited on account of the experiences we had.

For instances, we have 28 turkey producers that raise for a company, and 15, 20 years ago they had a great honeymoon. They started out with 7-year contracts, and renewed for 5 years, and then it became one and now they are on a flock-to-flock contract with no other competition around. That is what it is. So you tell me what kind of inter-generational opportunity there is as the prices went down. We have seen some poultry people, poultry contractors and even some hog contracts, basically had their 3-year contract and then were not renewed.

In some instances, a person came up to me one time and said, you know, people keep saying that investment of a half a million dollars into a contract operation is a great investment, a great opportunity, however they said, if I would have done that, invested in that particular company as a corporate stockholder 20 years ago instead of having just worn out poultry buildings at the time, I would have had $6.5 million.

I think the other point too is the danger of vertically integrated contract operators for rural communities is the fact that they normally do not utilize local resources, buying feed from the local company, support the local hardware store. Most of the time they come, actually suck out the resources and suck it out of the communities.

Mr. BELL. Could I respond to that, Mr. Chairman?

Chairman DEWINE. Sure.

Mr. BELL. My intake on that is completely 180 degrees in opposition.

Chairman DEWINE. Where do you buy your stuff?

Mr. BELL. Sir?

Chairman DEWINE. Where do you buy your products?

Mr. BELL. Well, in Kenansville, there is not many choices. We have got one hardware store. It is called Brown's Service Center. It is like the Wal-Mart of Duplin County. We can find everything we need there, from boots to whatever. I spend probably 4 to $5,000 a month there. I have about a 3 to $400 a month gas bill at the local gas station. The perception is—what he is talking about is a corporate business, the integrator—

Chairman DEWINE. Where does your feed come from?

Mr. BELL. I have absolutely no idea. It comes from a feed truck that comes to my farm. I have absolutely no idea.

Chairman DEWINE. I mean who do you buy it from though?

Mr. BELL. I do not buy any feed. I have no idea.

Chairman DEWINE. I am sorry?

Mr. BELL. I do not buy any feed. I have no idea. I do not own the feed or the pigs. I just own the buildings and the land.

Chairman DEWINE. But the feed is supplied by?

Mr. BELL. —Smithfield.

Mr. TWEETEN. Probably it comes from Cincinnati, Ohio.

Mr. BELL. But to respond to something he said a minute ago that I could not disagree with him more as a banker and as a common sense—

Chairman DEWINE. That would be nice if it did. It very well could be, but that was an interesting comment.

Mr. BELL. Mr. Chairman, one thing that I could not disagree with more that he said a minute ago, I understand what he is talking about, in the poultry business I have heard of that, you know, people wish they had not built the buildings, 20 years later they have a worn-out poultry house. The poultry business is a lot different than the hog business. They are completely different animals. I have got hog houses that I know in Duplin County where we are that are 30-years-old, still producing pigs every day, still on contract, getting raises on a contract, and I can assure if you are had gone to your local banker 20 years ago and said, hey, I want to borrow a half million dollars to buy some Tyson Food stock, he would have laughed you out of the bank. Now, they will lend you a half million dollars to build a poultry operation or a hog farm because you have consistent, steady cash flow. He is not going to lend you a half million dollars to buy some stock.

Chairman DEWINE. Dr. Tweeten?

Mr. TWEETEN. I think it is important to remember that this is not your father's Oldsmobile. This is a different kind of industry than we had two decades ago, three decades ago. Consumers have become much more affluent. They are demanding much more from the foods that they buy in the supermarket. My wife complains a great deal about her inability to buy the kind of bacon she is looking for.

What worked in the past in terms of meeting the needs of consumers does not work anymore; that is, you now need to have a system that tailors the production to the needs of consumers. That means lean pork. It means the right breeding program, the right feeding program, the right time and place of delivery, all these specifications. In the old days, we coordinated this whole system by the market at each stage of the food production and marketing process. That is getting much more difficult to do. It is now cheaper in many cases to use a managed system. That is where these production contracts come in.

There is a great deal to be said for the flexibility for firms to make their own decisions as to what best serves their need, and they cannot help but respond to the demands of the consumer.

Chairman DEWINE. Dr. Tweeten, in his testimony Mr. Kremer states that, and I quote, "Agribusiness firms are showing record profits while at the same time farmers and ranchers are struggling to survive and consumer food costs continue to rise."

This would seem to contradict your testimony, especially regarding food costs and the profitability of the processors. Do you want to respond to that?

Mr. TWEETEN. Well, yes. The profit margins in agribusiness are very modest, and they are very modest relative to other industries in this country. And as I say, in a recent paper I looked at ten different types of farms, and what we find is that commercial farms—and it turned out on average it took about $400,000 worth of sales. But farms with over $400,000 sales per year more than covered all their costs. They got rates of return comparable to what you see in other industries. In other words, this idea that markets do not work is simply a myth.

Now, you say the small farm, the inefficient farm should have a decent reward for its activities. Well, at Ohio State University, we

do not pay quarter-time teachers who are incompetent very well. So if a farmer is small—

Chairman DEWINE. I missed that. You do not do what?

Mr. TWEETEN. We do not pay teachers teaching one-tenth time and they are incompetent, we do not pay them very well. In fact, we dismiss them. They never get tenure.

The point is that if you are a small farmer who is inefficient, do not expect a very good return on your investment.

Now, we have an awful lot of small farms, and they have been holding their own pretty well. But they do it through off-farm income and it is a hobby farm and they are going to stay in business because they are supporting their hobby with their off-farm income. But the majority of production is produced by commercial farms that make a very favorable return on their investment. The majority of farmers, because they are too small or inefficient, lose money.

Mr. BELL. Mr. Chairman, if I could interject one more thing to what he said? And I am not an economist, and I am not from the Midwest so I do not understand some of the arguments being made or the mentality. But I will tell you this: It surprises me that when you look at economies of scale—

Chairman DEWINE. We have about the same mentality in the Midwest, Mr. Bell, as I am sure you do down South.

Mr. BELL. Well, we are little different down South. But what I do not understand, I guess, about the perception is that economies of scale work in other businesses, and it works in the row crop business. But in the hog business it does not seem to be something they want to consider.

Mr. SEBRING. Mr. Chairman?

Chairman DEWINE. Mr. Sebring?

Mr. SEBRING. Yes, I would like to respond, too. We have introduced some statistics to the Committee that show packer margins versus producer margins for the last 10, 12 years. And, historically, the producers have made more money per head than the packers, and very seldom does that reverse where the packing plants makes more money per head than the producer.

Chairman DEWINE. Mr. Hughes, what is your opinion about this?

Mr. HUGHES. Well, I think the—

Chairman DEWINE. You are a State enforcement officer. You can give us some insight on this.

Mr. HUGHES. Instead of talking about contracting per se, I think if you step out a little broader and look at concentration—I was just on the way out reading a magazine called Dairy Field that showed that last year the only growing aspect of the dairy industry where margins were healthy was in the fluid milk business. And it was because there is enough competitors left in that field that they are really trying to grow business volume, market share, and they are doing that through product innovation, and the fluid milk sales was the healthy part of the dairy business last year. I do not think that would occur if you got a more highly concentrated industry, and when you come to contracting in the dairy business at the producer level, they very much warn against trying to forward contract your milk for more than 50 percent of your milk volume. Now, it is not the same business as grain or vegetables or hogs. And I

think if you stuck the dairy industry into a strict contractual environment, you would have disincentives in that environment for some of the innovation that you would see otherwise where there is more choices for the producer to sell their product and meet different and varying specifications. That is where you are going to get the innovation all the way through the market chain.

Chairman DEWINE. Mr. Stumo?

Mr. STUMO. Chairman DeWine, I think we have been talking about the vertical system versus the open market system as if they are black and white in that they cannot co-exist, we either have one or the other.

I think in my perspective, in OCM's perspective, we need a sufficient open market that is resistant to manipulation, that is resistant to artificial depression of price, to discipline the contract side. If we go 100 percent vertical, as in poultry, with no market to discipline the returns to determine price, to have price discovery, everything is unilateral, packer-down, and contract modifications for every renewal.

Thus, we see gross profit margins increase 190 percent over 20 years for the poultry companies, and the poultry producers on average having zero return on investment, zero return on management, minimum wage, and a mortgage.

In the pork industry, we still do have a thin but it is an open market, and that disciplines the contracts. If we lose the open market, or if it becomes even more susceptible to manipulation, that does not discipline the contracts because people do not have an option to opt back into the open market. That is why it is important to have something like, for example, Senator Grassley and others have proposed a bill for 25-percent spot market each day, so that preserves an open market, allows the contracts, the open market is sufficient volume to be more resistant to manipulation, and that is one way to look at it. That is the way I look at it.

Chairman DEWINE. Well, I have heard from some of the other panelists who seem to imply you do not need any spot market. You obviously disagree with that.

Mr. STUMO. Yes, if you do not have that auction interface to determine price, to determine quality, with the quality specs and an open negotiating, negotiated haggling style bid going on all the time, then you have strictly a contract relationship where the power of the dominant firm in a contract relationship is exponentially greater than the power of a dominant firm in some sort of an auction or open market interface.

Chairman DEWINE. Dr. Tweeten, how far down can you get with percentage, spot market?

Mr. TWEETEN. I would say—

Chairman DEWINE. And still be viable.

Mr. TWEETEN. Zero.

Chairman DEWINE. You do not need a spot market?

Mr. TWEETEN. No. As I say, demand and supply—demand and supply operate whether you have a spot market or not. Furthermore, my experience is—and we have done some surveys on this—that the independents who are operating in the spot market are far unhappier with their economic situation than the farmers who are contracting.

Chairman DEWINE. Where, Dr. Tweeten, I am just trying to think in agriculture, where in agriculture has that happened so far?

Mr. TWEETEN. That there is on—

Chairman DEWINE. That there is no spot market.

Mr. TWEETEN. In a number of fruits and vegetables it is essentially all contract.

Chairman DEWINE. What would those be?

Mr. TWEETEN. I think of sweet corn, for example, in my area of the country. Many other fruits and vegetables I think follow pretty much the same pattern.

Chairman DEWINE. All contracted?

Mr. TWEETEN. All contracted.

Chairman DEWINE. And what has happened in those industries?

Mr. TWEETEN. They function very well. Function very well. And it is pointed out, too, by Mr. Sebring that in many cases companies like to have a bit of a spot market because if the contract production does not fit all their needs, they can always go into the cash market. The problem is that there is a great deal of instability in that cash market because it handles—it is a residual claimant on demand, and that means there is going to be a lot of volatility because some years they will come in and need a lot, in some years not so much. So it is highly volatile. And I cannot imagine that those spot market suppliers are going to be very happy with that arrangement.

Chairman DEWINE. Mr. Hughes?

Mr. HUGHES. I would just like to add, I think that although contracts, of course, have to respond to some kind of supply and demand condition, the idea that there needs to be—to make supply and demand work optimally, there needs to be very good information that is level on both sides of the bargaining table. And in the vegetable industry in Wisconsin, the only way that that mechanism is working is sort of twofold: one is that the processors know what the opportunity cost for a grower is to grow soybeans or corn or potatoes versus contract vegetables. But for the producers who may only have one or two choices in the marketplace, in order for them to make an informed decision, their association provides a function to provide a reporting mechanism because in this case the Government does not have a price reporting mechanism to make sure that the offered contract prices are transparent and, therefore, Producer A knows what Producers B, C, and D may be having as an option so that they have a little more information to make their decisions on. And I think that is a vital piece of the equation—transparency.

Chairman DEWINE. All right. Last statement, Mr. Sebring.

Mr. SEBRING. Two things, Mr. Chairman. Number one, that rule or law was passed not too long ago where we do report all of our spot buys every day. That is required by all of our competitors and by every packer.

I do not know of many industries where—for instance, General Motors does not tell Ford what it costs to build a car.

What we are saying today is we just do not want the Government to impose a ban on packer ownership and packer management for hog supply. The spot market works. We think the system today is working. But we have huge amounts of dollars invested in

packing houses, and we need to have a steady supply of high-quality hogs to keep those plants running, to keep people employed, and to keep our industry moving along and profitable for both sides. And we do think it is working, and that is all we are asking for.

Thank you.

Chairman DEWINE. Well, good. I want to thank you all very much. I know several of you have planes to catch. I appreciate it. Starting a hearing at 4 o'clock is not easy, and being interrupted by votes is not easy. Your testimony has been very helpful to the Subcommittee.

Thank you very much.

[Whereupon, at 6:20 p.m., the Subcommittee was adjourned.]

[Questions and answers and submissions for the record follow.]

QUESTIONS AND ANSWERS

JOHN MORRELL & CO.

OSEPH B. SEBRING
President & Chief Operating Officer

August 25, 2003

The Honorable Mike DeWine
Chairman, Subcommittee on Antitrust, Competition
Policy and Consumer Rights
161 Dirksen Senate Office Building
Washington, DC 20510

ATTN: Robin Blackwell

Dear Senator DeWine:

Thank you again for the opportunity to testify at your July 23, 2003 hearing on consolidation in the agriculture industry. I received your letter of August 8, 2003, transmitting additional written questions from you and Ranking Member Kohl. Enclosed you will find my answers to those questions. This document has also been transmitted by email to Robin Blackwell of your staff.

I have been pleased to participate in your subcommittee's examination of these important issues. Please don't hesitate to contact me if I can be of help in any way.

Sincerely,

Joseph B. Sebring

Joseph B. Sebring
President & COO

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United States Senate Committee on the Judiciary, Antitrust Subcommittee Hearing of July 23, 2003
"Agricultural Consolidation and Smithfield/Farmland Deal"
Response of Joseph Sebring to Written Questions of Chairman DeWine and Ranking Member Kohl

Chairman DeWine's Questions:

1. *Some have asserted that increased consolidation among processors allows the processors to achieve economies of scale through larger size. Is this assertion correct, and, if it is, can you outline some of the specific benefits that your company achieves though these economies of scale?*

The idea of economies of scale is a straightforward one, and you can likely anticipate the general thrust of my answer. But first I would like to offer a respectful qualification to a premise of the question. In our industry, like any other, economies of scale are achieved through growth, but growth is achieved in many ways, of which consolidation is only one. And consolidation does not always lead to growth. In addition to acquiring companies, I am proud to say that our growth over the years is due in great part to simply producing products that consumers like, so they will buy more of them from us.

All of the processes involved in producing our products, from slaughter through processing, packaging and delivery are to some extent made more efficient and less expensive, pound for pound, by doing them on a larger scale.

We operate in a very competitive marketplace. For us to compete successfully against others who produce protein (i.e., chicken, beef, pork) for consumers, we have to operate as efficiently and as cost-competitively as possible. Economies of scale are one way to achieve efficiency that benefits the consumer by making food prices as affordable as possible. Economies of scale also benefit pork producers as pork products compete effectively against other protein products due to economies of scale.

2. *What has driven the consolidation that we have seen among processors and who has benefited from that consolidation? In other words, have the benefits from consolidation among processors gone to anyone other than the processors themselves?*

In our industry, consolidation is driven by the economics of a highly competitive marketplace. Our marketplace consists of protein consumers, namely poultry, beef and pork. While per capita consumption is fairly static, individual products succeed based upon their appeal to the consumer. Primarily this appeal is based on quality and price of product.

Optimizing quality and price drives the producer to exercise tight control over the product to ensure quality and to produce efficiently to achieve competitive pricing. This control is achieved by vertical arrangements that permit control of the product as it is produced and processed. Efficiency is achieved through a number of means, including economies of scale by consolidation. When we have acquired companies, we have done it for complex business reasons, but always to be stronger, more competitive, and more profitable for our stockholders. Those acquisitions, as they take place across an industry in which companies face similar competitive pressures and incentives, can lead to consolidation, but consolidation is not an end in itself. When Smithfield buys a company, we buy it because we think it has value, and that it will increase the value of our company as a whole. So consolidation of an industry occurs because of practical decisions made by and about individual companies, but it can have advantages for others. The economies of scale and greater efficiency created by the individual transactions that comprise consolidation can lead to lower prices for our customers, and can make us more able to meet the increasingly tough and precise demands of our customers for quality and "custom" products. Meeting the consumer's demands is what keeps Smithfield and individual producers in business.

3. *Mr. Kremer and others have raised concerns about the promises that Smithfield has made to keep open the Farmland plants. Does Smithfield commit to keep open the Farmland plants that it acquires and the existing Smithfield plants? Also, how long does Smithfield plan to adhere to its promises to maintain Farmland's plants and contracts?*

Smithfield is committed to keeping open all of the Farmland Foods facilities it may soon acquire, as well as its existing facilities. We have no plans to close any of them. We understand that this is a broad assertion and that, in uncertain economic times, people want reassurances about their jobs. Our business is doing well, and we expect the addition of Farmland Foods will make its stronger still. Unless the circumstances of our business change significantly, all of the Farmland Foods plants and the existing Smithfield plants will remain open for the foreseeable future. If we do not acquire Farmland, it is entirely possible and even highly likely that one or more of the Farmland plants will be closed.

4. *One of the arguments that some have advanced regarding the positive benefits of vertical integration is that it allows processors to better respond to the demands of their retailer customers, especially for consistent products across many different retail locations. Is this argument correct, and if it is, can you briefly explain for us how vertical integration allows your company to better respond to the demands of retailers?*

I welcome the opportunity to elaborate on this issue, which I discussed in my testimony before the subcommittee. As I mentioned, the driving motivation behind this acquisition, and others, is to become even more responsive to our customers' demands, and to further our aim of providing the best and healthiest products at the most reasonable price to the consumer. Grocery retailers, chain restaurants and fast food retailers are our biggest customers. We give them precisely the products they demand, or they will find another pork processor with whom to do business. So when, for example, retailers told us that they wanted a very lean kind of pork, we developed our Lean Generation pork. It's much

leaner than most other pork, much leaner than any pork that was available not so long ago. We could not meet that demand without some vertical coordination in our business model. We make the decisions about how our hogs will be bred. We decide what our hogs will be fed. We decide how they will be cared for, and under what conditions. We control all of these factors for hogs we raise as well as hogs that are raised for us under contract. Without that input and transfer of technology, we couldn't give our customers Lean Generation pork. That would make us a less successful company and it would deprive consumers of an option they have really embraced, particularly in today's world with the emphasis on food safety and quality food products.

5. *Smithfield argues that it attains many benefits from its vertical arrangements. It is also clear that Smithfield continues to purchase a large number of hogs from the spot market. If the benefits of Smithfield's vertical arrangements are as numerous as it has claimed, why does it purchase as much from the spot market as it does?*

Smithfield purchases a significant portion of its hogs on the spot market for a number of reasons. In the Midwest, there is a larger producer base and many different types of production available, allowing the spot market to provide greater flexibility to meet customer demands in that region than it might, for example, in the East. This past year Smithfield purchased hogs from 20,000 different producers and in the Midwest we purchased more than 50% of the hogs that we slaughtered on the open spot market. Also, buying a significant portion of our hogs on the spot market allows us to respond to fluctuations in the marketplace in ways that will minimize fluctuations in earnings.

6. *You testified that vertical integration would better allow Smithfield to protect the meat it supplies to consumers. Can you outline how Smithfield can protect the food supply better through vertical integration than it could through buying from the spot market?*

Smithfield's vertically integrated system achieves greater food safety because it gives us the ability to monitor all aspects of the production process and to monitor and trace the product throughout the system. The production process takes place within farms owned by our company and by approximately 1,300 independent hog farms that contract with us to raise hogs according to our specifications. We provide those contract farms with all the animals, feed, supplies, medications and other key tools for raising hogs. We monitor and standardize feed ingredients, nutritional formulations, and feed quality testing and handling procedures from the farm all the way to the grocery store. All of this control of the process and unbroken custody of the product allows great "traceability". We know not just what is in the product and how it has been handled; we also know who has been permitted to have access to it, an especially important factor in these times.

For example, we routinely test ingredients coming into our feed mills. With regard to residue avoidance, our management practices and personnel are certified through the National Pork Board Quality Assurance Process. Further, we require strict adherence to FDA's Animal Medicinal Drug Usage Clarification Act requirements on all of the farms that raise Smithfield hogs. In addition, we have adopted an Antibiotic Usage Policy that goes beyond current regulatory requirements.

By comparison, hogs purchased from the spot market come from any number of farms, which may employ some, but not all, of these safety controls. These hogs cannot be traced with any confidence if a problem arises. In addition, our integrated process is better equipped to protect consumers against potential intentional threats because of our consistent chain of custody from conception to consumption.

Ranking Member Kohl's Questions:

1. *Critics of the Smithfield/Farmland merger are concerned with the fact that this merger will result in the top four hog processing companies controlling about 65% of the market. Further, they point out that Smithfield and Farmland currently operate competing pork plants in the western cornbelt region of Iowa,*

Nebraska and South Dakota. Won't this merger substantially increase the buying power of Smithfield in this region to the detriment of hog farmers? What will this mean for hog prices?

The parameters of the region described in the question are not relevant because hogs can be shipped in and out of that area easily. In the regions of Iowa, Nebraska and South Dakota that you describe, Smithfield and Farmland today do not compete for the same hogs, except in extremely limited areas where other competitors are aggressively present in the marketplace. An examination of the location of the two companies' hog slaughter facilities (and their competitors' facilities) and buying stations makes that plain. The hog slaughtering industry in the Midwest is not concentrated. Neither Smithfield nor Farmland (alone or combined) is remotely in a position to exert control in the Midwest for the purchase or slaughter of hogs. Smithfield and Farmland are the fourth and sixth largest competitors, respectively. Tyson will remain the largest competitor, while the second and third competitors, Swift and Excel, together will continue to be larger than Smithfield/Farmland in the Midwest. If Farmland Foods and Smithfield become a single company, it will not be the sole company buying hogs in Iowa, Nebraska and South Dakota. The acquisition of Farmland Foods will have no adverse effect on the price of hogs; there would still remain several other large buyers of hogs in the marketplace, more than enough to preserve competitive pricing. Indeed, the farmer-producers should take comfort that a proven and experienced operator will be buying Farmland, which could lead to an increase in pork demand because of the Farmland brands.

2. *Some in the agriculture industry have argued that the Department of Agriculture should be granted enhanced authority with respect to agricultural consolidation. In other industries, the Justice Department sometimes gives advice to the Department that regulates that industry. For example, when the FCC is considering whether to allow a local phone company to offer long distance service, the Justice Department gives the FCC and advisory opinion as to whether the local phone company has opened its facilities to competition in the state at issue.*

In light of this experience, why shouldn't we create a similar process with respect to agriculture, a process in which the Department of Agriculture could issue a public advisory opinion as to whether an agricultural merger is likely to harm competition an its effect on farmers?

We do not believe that the U.S. Department of Agriculture ("USDA") should assume a greater role in the already cumbersome process of determining whether a proposed merger or acquisition complies with antitrust law. Still, the analogy of the Federal Communications Commission ("FCC") to the USDA is a useful one for examining this question.

Under the Communications Act of 1934, the Congress created the FCC for the express and sole purpose of regulating the communications industry. Congress made a very explicit delegation of its powers to the FCC for that purpose. The Department of Agriculture is much larger and diverse in its functions than the FCC. The FCC issues a limited number of licenses allowing companies to enter various lines of business and itself plays a direct role in determining how many companies will have the opportunity to compete in those lines of business. Technical factors often mean that only a limited number of companies may compete in offering certain communications services, and those technical factors, along with communications technology itself, are integral to the economic analysis of proposed transactions in the communications industry. The same cannot be said for USDA and the diverse lines of business of the agriculture industry. To the extent that expertise about our industry is essential to the analysis now performed by the Justice Department, it is more than adequately done by the professional staff members in the Antitrust Division of the Justice Department, some of who specialize in examining transactions in our industry, and are more than up to the job.

Since the days of Teddy Roosevelt our industry has been subject to the restrictions on anticompetitive practices contained in the Sherman Act, the Clayton Act, the Robinson-Patman Act, the Federal Trade Commission Act, many state laws and key provisions of

the Uniform Commercial Code, and even another federal law that applies only to our industry: the Packers and Stockyards Act. We believe that there is enough regulation and scrutiny of competition within our business to ensure against anticompetitive behavior.

Some people may believe that adding USDA to the process will lead to better results, from their point of view. Others will disagree, but it seems clear that adding a new layer to the process will surely slow it down, and given the talents and expertise already dedicated to the job, we think that is reason enough not to take that step.

Our industry is one where there are no barriers to entry, in fact there is an "ease of entry" because there is no transfer of proprietary technology. In the last ten years, there have been four significant plants built:

a. Indiana – Central Soya and Mitsubishi
b. Oklahoma – Seaboard
c. Missouri – Premium Standard/Continental Grain
d. North Carolina – Smithfield

In the case of a, b, and c, the plants were built by parties not previously in the pork business. In addition, a group of farmers is currently planning to build a plant in Illinois.

Response to follow-up questions of Smithfield/Farmland deal hearing July 23, 2003.

Senator Dewine

1. Although I agree that economies of scale or critical mass do exist in each plant, they are not the driving forces for this consolidation. This consolidation, in my opinion, will have little effect on efficiency but rather is a matter of market power because of fewer players in the industry.
    a. I have researched alternative pork processing and marketing for ten years and have examined various systems in Europe. Plants as small as 1000 head per day can enjoy the same efficiencies as those slaughtering 15,000 per day. Those plants (1000 head per day) are large enough to fill full truck load orders of primal pork as well as drop (offal) products.
    b. A study funded by the National Pork Producers Council showed that plants as small as 2500 head per day can be as efficient as any plant.

2. The driving force of consolidation has been the elimination of competition which has led to the ability to acquire cheaper inputs and to gain more market power. Large retailers who prefer to deal with fewer vendors who can provide their volume needs, also benefit from consolidation.

3. I believe that the opposite is true. Large integrators have very fixed and inflexible production and processing systems. They are incapable of changing rapidly. They tend to produce in a manner that is most effective and efficient for them and then change consumer buying habits. Smaller systems, such as Ozark Mountain Pork Cooperative, in which I am president, are much more flexible and can involve, and respond to, the consumers' needs.

4. The greatest challenge that our co-op has faced is breaking the barriers of distribution and brokerage systems. Slotting fees asked by some distributors would cost us as much as $280,000 per year. Because of solid relationships established between brokers and retailers, our co-op has relied on existing brokers to market pork products. Unfortunately, these brokers often represent large firms such as Smithfield who have more resources, power and perks. Those products from the larger companies tend to be promoted more. Our best success has been in direct marketing to the many affinity groups in which our message resonates well.

5. I was a risk management consultant for 13 years and examined many contractual arrangements as a means of reducing risk. The greatest pitfall of contracts is that the contractors have much more power than contractees. The other major problem is that usually only one choice is available to producers in a given geographic area. In other words, in a given area, there is one choice to contract with hog packer, one turkey, one chicken, etc. The grower has little negotiating power with no competitive offers. As the volume of contract production

increases, the more captive agriculture supplies are and therefore the less competitive price bids are.

6. There is a greater need for transparency of contract terms and livestock price bids to enable producers to negotiate better prices at the marketplace. Our current price transparency law needs to be reformed to close protection loopholes that the largest producers are benefiting from.

Senator Kohl

1. The dairy industry has been consolidated into few large, global interests. These entities, because of little competition, excessive marketplace power and the ability to source products from countries that have inequitable production advantages, can source production at lower prices yet set retail prices at higher rates. I have personal experiences of these large businesses threatening both producers and small processors who attempt to develop a marketing arrangement. The Department of Justice must thoroughly examine all possible antitrust violations and the U.S. must stop the increase of imports due to liberal trade policies.
2. The Department of Agriculture should examine and issue a public advisory as to the likely harm an agriculture merger would have on competition. Consideration should be given to both agriculture business mergers and buyouts as well as retail food consolidation.
3. This merger will be the final blow to many independent producers in this trade area. I know producers in this area that currently have these two choices only. The Smithfield/Farmland deal would eliminate any competition thus eliminating any competitive bid. Hog prices will decline to break-even to below break-even prices as these farmers will become residual suppliers to Smithfield with little hope for decent bids.

Answers to Senator Mike DeWine's
Follow-up Questions to Michael Stumo
"Agricultural Consolidation and the Smithfield/Farmland Deal"
Hearing on July 16, 2003

1. Some have asserted that increased consolidation among processors allows the processors to achieve economies of scale through larger size. Do you believe that this argument is correct?

ANSWER: I believe that the benefits from economies of scale/scope plateau-ed at a much earlier time in the consolidation trend and that there are little, if any, further efficiencies of this type to be gained. The primary driver of consolidation is to increase market share and market power.

The proper term here is "economies of scope" – multi-plant efficiencies – rather than economies of scale – typically meaning larger physical operations at a single plant. Antitrust is concerned with whether the anticompetitive risks (harm to competition) outweigh the pro-competitive results or efficiencies (if passed on to others). There are many roads to efficiency, including (1) new technology; (2) new production concepts; (3) high quality management or personnel; (4) better use of information; (5) economies of scale; (6) economies of scope, etc. Of these roads to efficiency, economies of scale and, especially, scope present the antitrust concerns. These concerns are significantly heightened when the increase size comes as the result of elimination of a competitor. Thus, a more fundamental concept is the number of competitors in a market area and the impact on price, choice, and future innovation – or lack thereof.

a. Do you have a sense of how large a processor must become in order to achieve the benefits from economies of scale?

ANSWER: Smithfield will not become more efficient as a result of this acquisition because we are not talking about increased size of any plants. Smithfield will merely take ownership of existing plants to increase market share, the result being elimination of one of the six top tier firms in the sector. In fact, I am not aware that Smithfield has argued that they will become more efficient after the acquisition.

However, in general, maximum efficiency – defined as using less resources to produce more – from economies of size are achieved at much lower levels than company merger press releases would have us believe. New technology means that small plants can be as efficient as large plants. Small plants, however, can be disadvantaged by exclusionary market practices engaged in by the dominant firms in marketing to retail supermarkets. We at OCM believe that these wholesale to retail relationships are significant barriers to the entry of new firms.

b. Is there a size at which processors will no longer achieve economies of scale by growing larger? For example, in your opinion, has Smithfield reached a size such that it will not achieve additional economies of scale by growing larger?

ANSWER: I do not believe that there is any reasonable argument that Smithfield, the nation's number one hog processor, will increase its size efficiency as a result of the acquisition of existing Farmland Foods' plants. The better argument, a standard antitrust assumption, is that

firms can grow so large as to be inefficient, slothful, and a force to quash innovation that would have occurred if the industry were more diverse and competitive. Even if there are efficiencies of size, the question is whether the increase in market power (and the corresponding risk of anticompetitive practices) outweighs the claimed efficiencies and whether those efficiencies will be passed on to consumers or producers. The price spread data in my initial testimony shows that consumers and producers have not benefited from past consolidation in the last 10 years, and that market power increases outweigh any claimed efficiency gains.

In the general economy, Dr. F.M. Scherer of Harvard University showed that more than half of all mergers/acquisitions fail to provide the projected benefits to the company or shareholders, not to mention to social welfare.[1] He found that 57% of merged companies underperform their industry counterparts within three years of merger completion. The long term failure rate is higher.

In November 1999, KPMG Transactions Services released a study showing that 83% of mergers between 1996 and 1998 failed to produce shareholder benefits. Further, "more than half actually destroyed value," according to the report publicized by *The New York Times*.

2. What has driven the consolidation that we have seen among processors and who has benefited from the consolidation? In other words, have the benefits from the consolidation among processors gone to anyone other than the processors themselves?

ANSWER: Consolidation is driven by the urge to increase market share towards the intra-firm goal of increasing pricing power on both the buy side (monopsoy/oligopsony) and the sell side (monopoly/oligopoly). This is true generally, and with respect to packers and retail supermarkets. Both packers and retailers have increased their gross margins (the difference between the cost of goods sold and the revenues from those goods) at the expense of producers and consumers. Thus, the benefits have gone to the processors themselves.

3. Mr. Bell testified about the benefit of contract farming as a way to manage risks. In your opinion, does contract farming represent a rational method for farmers to respond to market risks? Are any policy concerns raised if farmers choose to manage risks by contract farming?

ANSWER: Mr. Bell, the North Carolina Smithfield contractor, has no choice to use the open market to sell hogs because the open market was closed down by Smithfield Foods which refused to buy in the Southeastern U.S. except through contracts. Thus, for Mr. Bell it is far more risky to try selling in a non-existent open market in that area. Yet Mr. Bell's hogs are likely priced in relation to the Iowa-Southern Minnesota hog market which still exists as a marginal open market. (90% of all hog contracts are priced in relation to a reported market). Mr. Bell's experience illustrates the problem rather than the solution.

There are several fundamental problems with contract farming:

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[1] Scherer, F.M., "Some Principals for Post-Chicago Antitrust Analysis," Case Western Reserve Law Review, Volume 52, (Fall 2001).

(1) They cause artificially low live hog prices: Contracts provide packers with committed inventory which packers can and do use strategically to artificially reduce live hog prices. Consider two scenarios:

a. First, if a packer needs to procure 10,000 hogs on a day to fill the plant and must bid for all the hogs, the first thousand are easily purchased, the second thousand are harder, the third thousand harder, and so on. It is hog number 10,000 that provides the market clearing price for the day because it is the highest price the packer is willing to pay on that day and the lowest price that the last seller is willing to take. That hog provides the discovered price in the market.

   However, if the same packer with a requirement of 10,000 hogs already has 8,000 hogs committed through contracts or packer ownership, then it must only buy 2,000 on the open market. The first one thousand are again easy, and the second thousand a bit harder. Here, it is hog number 2,000 that provides the price discovered in the market that day. It is a much lower price than if hog number 10,000 provided the discovered price.

b. Second, a packer has the ability and the incentive to schedule the contract and packer-owned hogs for slaughter in a manner designed to allow it to pull out of the market, crash the market price, and jump back into the market after the price crash. Contracts provide the packer with a bludgeon-sized tool to discipline the market.

(2) Contracts cause oversupply which depresses prices: Hog producers have complained that expansion in the production sector is driven by contract offerings by packers (and by packer demands for increased production from producers already tied into a contract) rather than through market price signals. Dr. Brian Buhr, a University of Minnesota ag economist, confirmed this in an article in the June 2003 issue of *National Hog Farmer* in which he says that there is a point where too many hogs are contracted to maintain a supply and demand response. The result is distorted markets and compromised price discovery.

   Lenders also help drive this because their credit scoring system provides higher scores for hog producers with a contract. The result is increased hog production with no downside price response, according to Dr. Buhr.

(3) Hog contracts do not reduce price risk because: (a) 90% are pegged to open market prices and are thus subject to the same price fluctuations; (b) they increase the packers ability to push live hog prices artificially lower than they would be in a competitive market, according to Dr. Robert Taylor of Auburn University; and (c) Dr. Brian Buhr's data shows that there is no long term benefit in profit or risk management. According to Dr. Buhr, "[n]o contract will pay an above average market price for a long period of time and no contract will reduce price risk without a fee or price discount (consider premiums on futures options as an example)." See, *National Hog Farmer*, June 2003.

(4) Hog contracts create increased incentives for packers to avoid bidding higher for hogs. If Packer A has no contracted hogs, and Packer A needs to bid higher for the last load of hogs to fill the plant for the day, then that higher price will only affect the cost of that last lot of hogs of, say, 100 head. However, if Packer B has, for example, 60% of its inventory committed through contract priced in relation to the open market, and Packer B is faced with bidding higher for that last load of 100 open market hogs, then Packer B is much more reluctant to do so because bidding higher will increase the price reported by USDA Market News thereby causing all the contract hogs to be more expensive. Conversely, Packer B has a tremendous incentive to use any strategy possible to reduce the open market price because success means making all the contract hogs cheaper.

(5) Price risk can be more effectively managed without committing inventory to packers. Producers can hedge all or part of their production on the Chicago Mercantile Exchange, or through third party brokers. Producers can also hedge their grain inputs in the same manner. The reason that producers are driven to contracts is to guarantee access to packer shackle space in this environment where the open markets are withering away.

4. Some have argued that there is a need for greater transparency of the contract terms between farmers and processors. Do you believe that there is a need for greater transparency and do you believe that the Livestock Mandatory Price Reporting Act is effective in bringing greater transparency? What kind of benefits do you believe would result from greater transparency?

ANSWER: Transparency and symmetrical information is necessary for markets to work properly. Dr. Joseph Stiglitz was awarded the Nobel Price in economics in 2002 based in large part on his work which makes this point. However, contracts are such an inherent distortion to the market that contract transparency is unlikely to provide significant benefits.

5. One of the concerns that some farmers raise is that as processors have grown in size, they have also grown in power. The fear that we heard from farmers is that as the power of processors grows, the processors' ability to force prices below competitive levels grows as well. This concern exist across our agriculture markets. How should policymakers balance the harms of the processors potentially exercising buyer market power against the efficiencies that larger processors can gain through economies of scale?

ANSWER: All growth in market share increases market power, even if the increase is relatively insignificant in the case of growth in a decentralized economic sector. The questions are whether there are efficiencies produced, whether those efficiencies can be captured in other ways not harmful to competition, and whether producer and consumers will benefit from those efficiencies. Here, market power increases tremendously, efficiencies of scale/scope have long been exhausted (in fact such efficiencies are not argued by Smithfield as present), and neither producers nor consumers are likely to benefit. Further, increased concentration will decrease producer marketing choices, increase barriers to entry for new firms, and thus prevent the innovation that new entrants could provide in the future.

The proper policy response is to prevent this acquisition so that new players are emboldened to bid on Farmland Foods in bankruptcy court. New players are highly unlikely to fight for the right to buy this profitable division of Farmland Industries with Smithfield in the game. Farmland Foods is worth far more to Smithfield than to new entrants because Smithfield is not only buying assets and a revenue stream, it is also shuttering a competitor with the prospect of cheapening its live hog prices and increasing its sell-side market power. New entrants are only buying the assets and a future revenue stream. However, the public interest in maintaining a competitive economy should trump the bankruptcy court interest in gaining the maximum value for creditors of Farmland Industries.

Further policy responses should be to: (1) prohibit packer ownership of livestock; and (2) require packers to purchase at least 25% of each day's inventory through negotiated, open market transactions in hogs. This will increase open market volume, increase the reliability price discovery, reduce market distortion, and reduce the packer market power achieved through vertical integration.

6. Outline how you believe current antitrust enforcement has failed, if at all, to address concerns with buyer market power in agriculture markets. For example, in your opinion, is there a problem with the Merger Guidelines or are there other problems with existing antitrust enforcement?

ANSWER: Monopsony, or buy-side market power, has received little attention in public enforcement, private litigation, and caselaw. The primary reason in recent years is that the predominance of the view that: (a) consumer harm is the exclusive antitrust concern; and (b) if monopsony/oligopsony power drives input prices down for processors, the consumer will benefit from lower prices. However, that view is both incorrect and it is changing. Policy makers can assist that change.

First, monopsony decreases economic productivity. A monopolist harms the economy because it artificially reduces supplies to drive prices up for consumers. This results in less production that would be the case in a competitive sector without artificial supply reductions. A monopsonist causes the same productivity harm. A monopsonist artificially reduces the quantity of inputs (in this case live hogs) demanded for inputs in order to drive price down. The result is again less units produced by the economy.

Second, consumers do not benefit from monopsony because there is virtually no correlation between low input prices for processors and low output prices. The reason that this attractive "price transmission theory" does not exist in fact is that the Power Buyers sell in a market with its own competitive dynamics, unrelated to the dynamics of the input market. In other words, the market clearing price determined in the Power Buyers' output market remains the same regardless of whether the Power Buyers procure in a competitive input market or not. (Blair and Harrison, *Monopsony*, Princeton University Press, 1993). In fact, because Power Buyers generally have some sell-side power, their output prices are predictably above perfectly competitive prices to some degree. The result is that monopsonists can increase the spread between the input price and the output price, thereby harming producers and providing no benefit to consumers.

Third, monopsony is harmful to future innovation because competitors are excluded and the industry becomes slothful.

Fourth, monopsony causes the distribution of resources to be skewed toward the packers in a way that an efficient market would not. The result is an artificial impoverishment of the production sector, artificially high profits for the processing sector, and an increased demand for taxpayer bailouts or assistance to producers.

Fifth, monopsony is causing rural poverty. The markets are the best source of rural development, far better than internet access or the occasional automotive manufacturing plant. In the past, poverty was primarily urban. Today, the lowest income counties in the nation are primarily rural. The result is not only poverty, but broken families, increased teenage pregnancies, and lower child birth weights. (Peters, 2002).

The Merger Guidelines at the Department of Justice do not deal well with monopsony and do not deal with vertical issues. The courts are awakening to the dangers of monopsony in some circuits (see for example, Todd v. Exxon, 2nd Circuit, Docket No. 01-7091, December 20, 2001). In the short term, Congress should persuade the Department of Justice to block the acquisition and consider a moratorium on agricultural mergers in livestock and grain processing. In the intermediate term, Congress should persuade the Department of Justice to implement Merger Guidelines that are more relevant to monopsony and vertical integration.

Senator Kohl's Follow-Up Questions for Agricultural Concentration Hearing For Michael Stumo

1. Our dairy farmers have seen a great decline in the prices they have received for their raw milk. But these reduced farm prices have not been passed on to consumers. While the national average price paid to farmers for fluid milk has declined by 13% since January 1999, the average national retail price paid by consumers at the grocery store has declined by only 5.5%. Why do the prices farmers receive for their milk continue to decline while consumers see little if any benefit? What steps should be taken to ensure that consumers and producers benefit from increased competition in the dairy industry?

ANSWER: The dairy price spreads are increasing because processors and retailers have increased market power, and either there are few efficiencies created or the anticompetitive nature of the sector result in those efficiencies not being passed on. Both the dairy processing and the retail supermarket sectors are at historically high concentration levels. In dairy processing, Dairy Farmers of America, Dairy Marketing Services, National Dairy Holdings, and Dean Foods (formerly Suiza) have interlocking relationships which cause them to cooperate rather than compete. At retail, Wal-Mart and Krogers have a 25% market share, and 33% when we add Albertson's. Further, the vertical relationships between the dairy processors and the retailers both maximize the profit of this bi-lateral monopoly and serve to exclude competitors, both existing and potential, from gaining a competitive foothold.

The public policy response should be as follows: (1) DOJ Antitrust should break up the marketing relationships mentioned above as to the dairy processors; (2) Congress should enact a Packers & Stockyards-like law for dairy to prohibit "unfair and deceptive practices," price discrimination, and activities that have the purpose or effect of reducing price, choice or innovation; and (3) DOJ Antitrust should terminate the exclusionary vertical relationships between the biggest processors and the big retailers so that new and existing competitors have the ability to market their product based upon quality and efficiency grounds.

2. Some in the agriculture industry have argued that the Department of Agriculture should be granted enhanced authority with respect to agricultural consolidation. In other industries, the Justice Department sometimes gives advice to the department that regulates that industry. For example, when the FCC is considering whether to allow a local phone company to offer long distance service, the Justice Department gives the FCC an advisory opinion as to whether the local phone company has opened its facilities to competition in the state at issue. In light of this experience, why shouldn't we create a similar process with respect to agriculture, a process in which the Department of Agriculture could issue a public advisory opinion as to whether an agricultural merger is likely to harm competition and its effect on farmers?

ANSWER: I do not believe USDA will be helpful in this regard because USDA holds the naïve view that the structural change in agriculture is "natural", rather than driven by problematic market power concerns, and that the policy response should be zero. In practice, USDA does provide information and advice to DOJ Antitrust today with regard to agricultural mergers and acquisitions. Further, USDA has, for the past 80 years, had the statutory ability in the livestock sector to refer anticompetitive problems to DOJ Antitrust for action under the Packers & Stockyards Act.

However, USDA does require an enhanced ability and desire to identify and investigate anticompetitive mergers, acquisitions and practices in agriculture generally with a new regime. The current regulatory regime at USDA is one in which USDA only has jurisdiction over the livestock and poultry competition issues pursuant to the Packers & Stockyards Act and the Agricultural Fair Practices Act. These are good laws that have not been enforced. The relevant subpart of USDA, the Packers & Stockyards Division, has never propounded regulations to clarify what is anticompetitive or unfair, and has not chosen to hire administrators who are lawyers with experience and knowledge with regard to competition or industrial organization. This scenario is as absurd as if the Department of Justice hired a nonlawyer with no antitrust experience to head is Antitrust Division.

Congress should consider the following actions: (1) enact a law similar to the Packers & Stockyards Act to prohibit unfair, deceptive, discriminatory and anticompetitive conduct by processors against producers of all commodities – not just livestock; and (2) create an Office of Special Counsel for Competition within USDA as an undersecretary level position which has concurrent jurisdiction with DOJ over ag-relevant competition laws, while leaving jurisdiction of the non-competition aspects of the Packers & Stockyards Act (i.e. weights and measures, prompt payment and bonding) to the Packers & Stockyards Division of USDA. The head of the Office of Special Counsel for Competition at USDA should always be a lawyer qualified to oversee, investigate and enforce the agricultural competition laws.

3. Shouldn't we be concerned with the concentration in the hog processing industry, especially as the Smithfield/Farmland merger will result in four hog processors controlling about 65% of the hog packing market? Doesn't this level of concentration mean that individual hog farmers have little choice as to where to sell their product and little bargaining power as compared to food processors? What will this mean for hog prices?

ANSWER: Congress should be concerned for the reasons stated above. Horizontal concentration harms price, choice and innovation. Vertical integration is even more damaging to competition because it provides powerful tools and incentives for the dominant firms to artificially reduce prices and to exclude competitors.

Senator Mike DeWine
Reply by Luther Tweeten to Follow-up Questions
"Agricultural Consolidation and the Smithfield/Farmland Deal"

1. Every study I have seen for the 1990s or later shows economies of plant size; i.e., unit cost of meat processing falls with greater plant size. Cost per unit of output undoubtedly increases at a very large output but that point is beyond the data available to economists. Clem Ward, Extension Livestock Marketing Economist at Oklahoma State University, in his recent publication *Packer Concentration and Captive Supplies* summarized results from three studies of economies of plant size in cattle slaughter (http://pearl.agcomm.okstate.edu/agecon/marketing/wf-554.html). Unit costs declined 26 percent on average as plant size increased from 150,000 to 1 million head per year. Cost per unit continued to decline for larger plants but at a slower rate. For example, costs fell only about 5 % as plant size increased from 1 million to 1.4 million head slaughtered per year. Although the percentage reduction in cost is small, the *total* cost saving is substantial when the large volume is considered. As Ward explains, lower costs mean meatpackers can pay higher prices for fed cattle. Even a $5 reduction in average slaughtering-fabricating cost per head could potentially translate into $0.35-0.50/cwt. higher prices paid for fed cattle.

   A couple of caveats are in order. One is that these results are for beef. The pattern for hogs is like that for beef. MacDonald and Ollinger found economies of size in hog slaughtering based on their own and other studies (see http://www.ers.usda.gov/publications/aer785). Second, the results are for plants—unfortunately data are sparse on economies of *firm* size. Economies of firm size are likely to be sizable because a large firm can advertise in national media and can absorb shocks from man and nature by averaging across many facilities. A Firms increase size to realize economies of scope, spreading fixed costs over more units of output. Multi-plant firms are less vulnerable to food safety problems. If one plant has problems, then other plants may still be able to function. Economists, bureaucrats, and public officials do not have a good record of setting an "optimal" size beyond which firms are not allowed to grow. That decision for Smithfield and other firms is best made by the market. Firms will merge and split as they wrestle with trying to find the optimal size.

2. I believe there is need for greater transparency in contract terms between farmers and packers as well as other contractors. A problem is that the industry does not have a uniform reporting procedure. It is not easy to formulate a uniform system because of the varied nature of current contracts. Producers, contractors, and other relevant parties need to sit down and devise a reporting framework. Producers and others will have the information they need to compare contract terms when a reporting system has been implemented and results circulated widely. I am not an expert on the Livestock Mandatory Reporting Act, but my impression is that it is working reasonably well. It just doesn't go far enough.

3. Packers must have hogs and cattle or they will go broke. Producers will take a loss in the short run and continue to deliver animals to packers, but they will not do so as the time period is extended. Well-run commercial size livestock operations historically have covered all costs of operation averaged over the commodity cycle. Thus the market protects producers. Many producers are too small and inefficient to stay in business even as well-managed, adequate size producers are making a nice profit. These inefficient producers unfairly blame their problems on packers. A growing number of studies indicate that the influence of market power on farm livestock prices is very small and is dominated by economies of size passed to producers. The four largest packers had net operating income of only 0.5% of sales in 1992, 3.3% in 1993, and 1.4% in 1998. If the profit above 1% of sales in 1998 were arbitrarily classified as "excessive" and were returned to farmers as higher prices, it would have added only $1/cwt. to fed cattle prices. Thus removing market power and excess profit from the packing industry would have little positive impact and could have a large negative impact on livestock producers.

4. Small independent livestock producers are going out of business because technology has created economies of size. To be sure, contracting has speeded transfer of that technology to farmers, but size-biased technology will eventually create problems of competitiveness for small farmers with or without vertical integration. (See Luther Tweeten and Cornelia Flora. March 2001. *Vertical Coordination of Agriculture in Farming-Dependent Counties.* Task Force Report No. 137. Ames, IA: Council for Agricultural Science and Technology.)

5. Packers have never been and never will be generous to livestock producers, on average over the long run paying more than necessary to get the animals they need for slaughter. However, as I stated in my testimony on July 23, the oligopolistic marketing sector is very much into food promotion and innovation. The greater food sales that result benefit farmers by creating more demand for farm products. To produce that additional farm output, farmers will buy more agricultural inputs.

Senator Kohl's Follow-up Questions

1. Close scrutiny reveals that your numbers do not justify your concerns about the structure of the dairy processing and marketing industries. The 13% drop in farm price is a 9-cent drop in the price of a half-gallon of milk at the farm level. The 5.5% drop in retail price is an 8-cent drop in the price of a half-gallon of milk at retail. Rising labor and other costs in the processing/marketing sector added 2 cents to the price of milk charged consumers. To fully pass the farm price decline to consumers, the half-gallon milk price would need to have fallen by 9-2=7 cents at retail. But your numbers indicated the price fell 8 cents, hence retailers more than passed on the price decline to consumers. It's hard to fault that behavior. The way to promote price competition in the dairy industry is to end government interventions that regulate and administer prices.

2. Having the U.S. Department of Agriculture give advisory opinions on mergers and acquisitions would add to bureaucracy in Washington and do little to enhance antitrust policy. The reason is that the USDA would have a tendency to promote the interest of farmers and cooperatives and likely would not give opinions that balance the interests of all producers, consumers, and the public at large. The Justice Department and the Federal Trade Commission can be given additional resources, if needed, to evaluate the impact of proposed mergers and acquisitions in agriculture and other industries.

3. The four-firm concentration ratio of 65% found in hog processing is not unusual; it is 80% in beef processing. Some studies cited by Clem Ward (see my reply to Senator DeWine) indicate that increasing concentration in beef packing slightly lowers farm level prices. Other studies cited by Suresh and Tweeten (Suresh Persaud and Luther Tweeten. "Impact of Agribusiness Market Power on Farmers." Chapter 7 in L. Tweeten and S. Thompson, eds., *Agricultural Policy for the 21st Century.* Ames: Iowa State Press, 2002) indicate that increasing processor concentration (studied individually for beef, swine, and poultry) reduced marketing margins because achieved economies of size reducing costs more than offset tendencies for higher margins from greater market power. The benefits of added concentration were found to be passed to consumers, not to farmers.

   Concentration at local levels is especially high but unavoidable. That does not imply hardship to farmers. Modern highways and transport allow producers to ship livestock 100 miles or more to reach the best market. And pork must compete with beef and chicken in the diets of consumers. GIPSA found that the livestock industry essentially operates as one national market and not as a set of local monopolies. As stated in my reply to Senator DeWine, processors must cover the full costs for able commercial livestock producers to deliver essential inputs to processing plants over time—empirical evidence for that conclusion is compelling. Critical determinants in hog pricing will be the cost of feed, labor, and other inputs and the efficiency with which inputs are turned into output. Concentration in food processing will have little if any impact on livestock prices paid to farmers.

SUBMISSIONS FOR THE RECORD

TESTIMONY TO THE UNITED STATES SENATE JUDICIARY COMMITTEE REGARDING THE COMPETITIVE ENVIRONMENT FOR DAIRY AND LIVESTOCK PRODUCERS

JULY 23, 2003

Introduction

My name is Robert D. Wellington and I serve as Senior Vice-President for Economics, Communications and Legislative Affairs for Agri-Mark Dairy Cooperative. Agri-Mark is a farmer-owned and controlled Capper-Volstead cooperative with approximately 1450 member dairy farms located throughout New York and the six New England states. We market about three billion pounds of farm milk annually. This represents slightly less than two percent of U.S. milk production.

Agri-Mark is extremely concerned about the changes in the competitive environment for its members' milk production. A decade ago, Agri-Mark could compete to sell its milk to any or all of more than a dozen major purchasers of fresh, Class I drinking milk. This would allow its member farms to fully share in the obligations and benefits of pooling milk under a Federal Milk Marketing Order. However, most of the Class I bottling plants in New England have been bought (and in several cases subsequently closed) by one handler, Suiza Foods. It has been estimated that they have more than 70% of the Class I market in New England alone. Suiza Foods, also the largest seller of Class I fresh drinking milk in the country, subsequently merged with Dean Foods, the second largest Class I seller. The resulting mega-company retained the name Dean Foods. Dean Foods currently has a full milk supply arrangement with Dairy Farmers of America.

Dairy Farmers of America (DFA)

Dairy Farmers of America ("DFA") is the result of the mergers of a number of large cooperatives, including Dairymen, Inc., Mid-America Dairymen, the Southern Region of Associated Milk Producers, Inc. and others. These constituent groups have a pedigree of antitrust violations dating back over sixty years.[1] Despite having been sued

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[1] Reported decisions and decrees include:

United States v. Borden, 1940-1943 Trade Cas. (CCH) ¶ 56,062 (N.D. Ill. 1940);

United States of America v. Associated Milk Producers, Inc., 394 F. Supp. 29 (W.D. Mo. 1975);

United States v. Mid-America Dairymen, Inc., 1977-1 Trade Cas. (CCH) ¶ 61,508 (W.D. Mo. 1977);

United States v. Dairymen, Inc., 1983-2 Trade Cas. (CCH) ¶ 65,651 (W.D. Ky. 1983);

Alexander v. National Farmers' Organization, 645 F. Supp. 1146 (W.D. Mo. 1986).

repeatedly by the Department of Justice, various state agencies and private parties, and despite being subject to numerous permanent injunctions prohibiting predatory and anti-competitive behavior, DFA has persisted in flouting these injunctions and employing predatory tactics to gain a stranglehold on dairy production and producers throughout the Mid-West. DFA is probably the most blatant antitrust recidivist in the history of this country.

The First Proposed NDH/Hood Merger

Last fall, Agri-Mark's largest remaining customer, the H.P. Hood Company, announced that it was merging with National Dairy Holdings (NDH). NDH is owned and controlled by DFA. DFA was to have a full milk supply arrangement with the new Hood/NDH company. This would have left Agri-Mark with insufficient Class I sales to meet Federal Order Class I pooling requirements throughout the year and could have lowered the annual farm income of our members by more than $50 million dollars. Agri-Mark's average size member farm would have lost about $30,000 annually if it was not sharing in the Federal Order pool. As has happened in the past, Agri-Mark and/or its members likely would have been forced to join or affiliate with DFA.

We protested this proposed transaction to the Department of Justice. The concern we expressed was that DFA, which is far and away the largest dairy cooperative in the United States, intended to use this transaction to increase its market share at the expense of independent dairy producers, including Agri-Mark. We described DFA's history of predatory conduct, and demonstrated that the proposed merger was merely one more step – different in scope but not in kind – in DFA's pattern of driving out competing milk cooperatives and independent producers.

We also pointed to the experience of small cooperatives and independent producers who formerly supplied plants acquired by DFA, Dean or NDH in Nashville, Somerset (Kentucky), Idaho, New England, Dairylea in New York, and St. Alban's in New England. These cooperatives were given a Hobson's choice – market through DFA to your former customer or cease dairy operations – *after* being acquired by DFA. Most recently, on May 1, 2003, DFA struck again. Its affiliate, Lone Star, displaced the independent producers who had historically supplied Mid-States Dairy in St. Louis. Mid-States "encouraged" the displaced producers to join DFA's affiliate or lose their market.

The "New And Improved" NDH/Hood/DFA Transaction

In late April of this year, we received reports that the NDH/Hood deal had been abandoned. At the same time, however, DFA announced that it intended to "restructure" the NDH/Hood transaction as an exchange in stock and CEOs (in effect, a "virtual merger") and go forward with it. On May 13, 2003, the press reported that the parties intended to consummate the deal, albeit in a slightly altered form.

The NDH/Hood/DFA Transaction May Be Different, But It's No Better

Rumors in the industry have suggested that the "new" NDH/Hood/DFA deal may have been structured to make it non-reportable for Hart-Scott-Rodino purposes. Obviously, DFA cynically believes that it can thumb its nose at the Antitrust Division and "slam" this deal through with only some cosmetic changes. *This cannot be permitted to happen.* The proposed restructuring of the deal may be a more subtle tactic than the originally-proposed merger, but it will be no less harmful to DFA's competitors. All the statements by the principals involved, including the principal architect of the transaction, Gary Hanman, CEO of DFA, indicate that they will accomplish the very same goals sought by the originally-proposed merger.

The DFA press release did not refer to any supply arrangements, as part of the transaction or otherwise, except for these two comments:

1. There was a brief and unexplained statement that Agri-Mark would not be (immediately?) displaced as a supplier to Hood; and

2. It was indicated that DFA would become the new supplier to the Hood plant at Winchester, Virginia.

However, Agri-Mark has heard in the field that Land O'Lakes ("LOL") has been offered a deal by DFA: If LOL agreed to join DMS – a marketing agency in the Northeast controlled by DFA – DFA would not take over the supply at the Hood-Winchester plant in Virginia but would permit LOL to continue its historical supply arrangement at Winchester. Otherwise, DFA would, under the "restructured" transaction, oust LOL as supplier of the Hood plant at Winchester. LOL has now agreed to market through DMS.

It is plain that the contemplated three-way federation between and among DFA, NDH and Hood is inherently and inescapably fraught with anti-competitive dangers. As a result of the transaction, Hood, which is the prize DFA is pursuing,[2] will be 15% owned by DFA. This will represent a substantial degree of DFA control over Hood. Moreover, Hood in turn will acquire a 30% interest in NDH, thus becoming a co-venturer with DFA in NDH. There is no ambiguity as to what is going on here: DFA, NDH and Hood will be fused into a single, coordinated economic unit. To cement the relationship, Hood's president and chief executive, John Kaneb, will become chairman and chief executive of NDH and NDH's current president, Tracy Noll, will move over to become Hood's president. In short, the proposed transaction is a "virtual merger" of DFA, NDH and

[2] Because DFA already controls NDH, it has no need to extend its control over NDH. We do not know the details of the transaction but we assume that Hood's "minority investment" in NDH will likely take the form of a purchase of some of DFA's interest in NDH, perhaps to help bail DFA out of the liquidity problems DFA has incurred in the course of its "buying up the world" campaign. If so, there will be no dilution of DFA's control over NDH because post-transaction DFA will own 15% of Hood's shares.

Hood. This virtual merger is consistent with DFA's pattern of predatory conduct, and should be aggressively investigated, regardless of its reportability under Hart-Scott-Rodino.

DFA's Use of Federal Order Rules to Achieve Monopoly

The anti-competitive effect of the proposed NDH/Hood/DFA transaction is magnified by DFA's history of exploiting monopoly-building opportunities under USDA's Federal Milk Order market access ("pooling") rules. A prime example of this exploitation can be seen in the recent regulatory "reform" of Milk Order rules and USDA's receptiveness to new regulatory limits on market access, limits fashioned and proposed by DFA, the largest cooperative constituent of USDA programs.

As described in the Justice Department's 1977 publication, *Milk Marketing* (a Report to the Task Group on Antitrust Immunities) at 292-393, many anti-competitive practices in the milk business are dependent upon the existence and structure of Federal Milk Marketing Orders. This continues to be true under USDA's new regulatory structure. The creation of larger federal milk markets no longer serves to preserve competition because the trend toward consolidation of processing plants and cooperatives severely limits market options for dairy farmers.

The most visible anti-competitive Milk Order practice in the 1970's was "pool loading" – use of Federal Order rules to load surplus milk onto the market of competitors for the purpose of depressing the pooled blend price to coerce non-member farmers to join the dominant cooperative. Current practices are less transparent, but no less effective, in their coercive result. Ironically, these practices are designed to "unload" milk of competitors from a pool. DFA's favored tactic has been to acquire the Class I processors in a market, thus capturing their attendant supply needs and as a result: (1) force competitors to shift to an alternative market with a lower blend price, (2) leave competitors with no access to a regulated federal market pool, or (3) require competitors to pay a market access tribute to DFA for the "service" of associating milk with a federal milk pool, reducing non-member revenue while enhancing DFA revenue. In other words, the injury to independent cooperatives and producers is not confined to the lost sales to Class I customers; it also includes the independents' loss of the ability to pool their milk on Federal Orders because sales to Class I customers are the "gateway" to Federal Order pooling.

DFA's strategy of denying access to markets has been structured around this new USDA regulatory environment. Federal Order market access is governed by pool qualification rules, which entitle dairy farmers to a revenue stream above the surplus (Class III) price in the form of a "Producer Price Differential" ("PPD"). Pool qualification entitles the dairy farmer (or his cooperative) to market milk and draw the PPD on a volume of milk equal to the volume of distributing (Class I fluid milk) plant sales, *times a multiple*. In section 1032.13 of the Central Market, for example, the

multiple is five -- i.e., for each hundredweight of milk sold to a Class I fluid milk plant, 500 pounds of milk may be pooled and draw the PPD. The right to an enhanced revenue stream to the holder of pool qualification thus has clear economic value. Market access gained by milk supply to fluid distributing plants also has, by its function of denying pooling and participation in the PPD, negative or exclusionary effects on competitors.

In the Northeast, there is currently no absolute limit, but proposals are pending and likely to be adopted (with the urging of DFA and allies) to limit pooled milk to a multiple of 5 (i.e., 80% of the milk supply may be diverted). Thus, DFA's acquisition of HP Hood or a supply contract for Hood's monthly distributing plant receipts of 60 million pounds (est. for 6 plants) will lock up 300 million pounds per month or 10 million pounds per day in pool access, and deny pooling opportunity for 300 million pounds per month of its competitors' milk.

DFA's Monopolizing of Local Milk Markets

It is crucial to dairy farmers to have regular, committed and nearby outlets for the milk they produce on their farm. Farm milk is bulky and highly perishable and is picked up at farms either every day or every other day. That milk must find a market immediately as it can not be stored in its raw form for more than a day or two; moreover the milk tanker itself is needed to pick up the next load of milk either that same day or the next. Agri-Mark members produce a 50,000-pound trailer load of milk every nine minutes of every day, 365 days a year. This includes weekends and holidays too.

In addition to its merger tactics and manipulation of the Federal Order system, DFA simply used its economic muscle to buy up market outlets for milk even though it does not have the local milk supply to service that milk. If need be, they transport milk into their new customer at great expense while local farmers struggle with what to do with their own milk. Usually, local farmers quickly recognize that they have no choice but to capitulate to and join DFA in order to have a market for their milk. DFA effectively removes both competition and choice for these producers. Instead of gaining membership through farmer choice as we and most other cooperatives do, DFA gains it by eliminating choice. We believe this is wrong for farmers, cooperatives and the marketplace.

Farmers have the opportunity to market their milk together through cooperatives under the Capper-Volstead Act. Cooperatives can also work together to jointly market milk under that Act. We strongly support the ability of farmers and cooperatives to do so and have done so ourselves. However we also believe it should be a choice for both farmers and their cooperatives to work together. It should not be forced upon them though the elimination of choice and competition as has often been the case involving DFA. Agri-Mark believes that cooperation amongst farmers and their cooperatives can benefit farmers but farmers must also have competition for their milk at the farm level. One large milk buying entity, be it cooperative or private company, invariably forces

farmers to be strictly price takers for their milk and minimizes their income. It also allows that organization, even if it is a cooperative, to ignore the local needs of their members and transfer income from those farmers to other areas of the country where they are seeking to expand there influence and economic power.

Conclusion

In summary, Agri-Mark and its farmer-members believe that the elimination of competition for farm milk supplies is bad for farmers, consumers and the marketplace. This is particularly the case when companies such as Dean Foods obtain such a huge majority of the Class I marketplace in a region and cooperatives such as DFA effectively buy a near monopoly on the ability to supply Dean Foods as well as other Class I outlets. These activities are plainly anti-competitive and the appropriate law enforcement agencies should take the appropriate steps necessary to address these issues.

Testimony
United States Senate Committee on the Judiciary
Agricultural Consolidation and the Smithfield/Farmland Deal.
July 23, 2003

Mr. Patrick Bell
Farmer ,

Testimony of Patrick Bell
Before the Antitrust Subcommittee of the
U.S. Senate Judiciary Committee
July 23, 2003

My name is Patrick Bell and I am a contract hog farmer from North Carolina.

I came to give you my perspective as someone who is on the farm everyday because I think it is important for the committee to hear from someone who actually have a hog farm under contract with Murphy Farms, which is a part of Smithfield Foods.

I would like to begin by telling the committee about my background.

I grew up in a small town named Kenansville, in eastern North Carolina. It was a tight knit community of about 900 people where agriculture was the most important industry. I come from a farming family, but when I was ready to begin my working life, it really wasn't an option for me to work full time on our family's farm and certainly not to get my own farm. I went to college and after graduating from The University of North Carolina in Chapel Hill I worked in the banking industry for about 10 years as a branch manager and commercial loan officer.

In 1992 I turned 30 years old and my father celebrated his 60th birthday the same year. That year I was just the same age that he had been when I was born and he sat me down and gave me a choice: as my parents' only child I could continue in banking and commit to a life outside farming or I could return home to my small town, which had very little industry or opportunity beyond the farm, and take over our contract hog farming operation.

That decision was a difficult one for me but I decided to return home and go into business with my father. That was nine years ago and we have had some struggles, but since then we have expanded our operation to almost twice its original size. Now our farm earns enough to allow me to support my family, and that gives me great satisfaction.

In hindsight, the decision to return home was one of the best decisions I have ever made because it has allowed me to live in the small town I love, be in the business I love with my father, and provide for my family while building some long term security.

My family and I have a deep emotional attachment to farming, but I always understood that my decision to become a hog farmer also was a business decision. When I decided to return home and enter into a contract agreement with Murphy Farms I had three main questions: 1) if I invest my family's savings in this farm, will it be an investment that has some good solid cash flow? 2) does the company that I will contract with have the ability to pay my contract, can I count on them? 3) will this investment provide a stable income and a reliable profit in the long term for my family?

After being in the hog business for 15 years under contract, first for just my father and then for us

both, I'm happy to say that the answer to all three questions has been absolutely yes.

Finally I think it is important for the committee to understand that in North Carolina the hog business is not owned by some nameless, faceless, monolithic corporation or group of people. In my state, and most any hog-producing state, the hog business is composed of small farmers like me. In fact, small farmers like me grow about 80% of Smithfield's hogs in North Carolina. The contracts we have make it possible to stay on the family farm or come back home and provide for our families by growing hogs under contract with Smithfield. When I sign that contract, I get a fair price, but that's not all. I get to know what the future holds for my family. I know that Smithfield bears the costs supplies the expertise to ensure that we comply with environmental and safety regulations I get to tell the people I do business with that they can count on the stability of my business - so the banker, the store that sells me feed and everybody else knows that they can extend me credit with confidence. When I was a banker, I had the unhappy duty of turning down some good farmers for loans, because they didn't have contracts for their hogs and we couldn't be sure that they would be able to meet their obligations. It was a hard thing to do, and I am grateful that my business is not subject to that kind of uncertainty.

I don't know the details of the Smithfield/Farmland acquisition, but I am sure that the hog farmers who had contracts with Farmland are very glad that Smithfield intends to honor those contracts. I know from experience that they will be dealing with honorable people, that they will get a fair price and that they will enjoy stability in their businesses that will help to keep their family farms alive and thriving. Thank you for the opportunity to address the committee.

Testimony of
J. Patrick Boyle
President and CEO
American Meat Institute
Before the Senate Judiciary
Subcommittee on Antitrust, Business Rights and Competition

July 23, 2003

My name is Patrick Boyle and I am president of the American Meat Institute. AMI has provided service to the nation's meat and poultry industry -- an industry that employs nearly 800,000 individuals and contributes about $90 billion in sales to the nation's economy -- for more than 97 years.

Among AMI's member companies, 60 percent are small, family-owned businesses employing fewer than 100 individuals. These companies operate, compete, sometimes struggle and mostly thrive in what has become one of the toughest, most competitive and certainly the most scrutinized sectors of our economy: meat packing and processing.

The business practices of AMI's member companies, large and small alike, are governed nationally not only by the Sherman Act, the Clayton Act, the Robinson-Patman Act and the Uniform Commercial Code, but also by the Packers and Stockyards Act, a statute unique to our industry that clearly prohibits meat packers from engaging in unfair or deceptive business practices that disadvantage their livestock suppliers. To my knowledge, there is no other sector of the U.S. manufacturing or service economy in which the federal government plays such a watchdog role with respect to raw material suppliers.

Ironically, as the meat and poultry industry operates with this additional, daily, government oversight of our business transactions with livestock producers, we are here today to discuss whether meat packers should receive additional scrutiny, enforcement or business restrictions in order to benefit livestock producers.

I am confident that the federal government has all of the tools necessary to review pending mergers and acquisitions under current law and I am particularly confident that this is true for the meat and poultry industry with the additional layers of scrutiny.

Questions about the structure of the meat industry have been raised throughout AMI's existence. Although some suggest our laws and the enforcement of them are inadequate, I suggest another theory: perhaps we haven't done a good job of pinpointing some of the real problems and coming up with constructive solutions that benefit everyone.

Let me characterize the environment in which my member companies operate today. AMI members include 250 of the nation's largest and smallest meat and poultry food manufacturers. Collectively, they produce 95 percent of the beef, pork, veal and lamb food products and 75 percent of the turkey food products in the U.S.

The entire food production, distribution and marketing sector has undergone phenomenal change in the past decade. Consumers have increased their demands for consistent, low-priced products. These demands have driven consolidation in the retail and foodservice sectors. In turn, food manufacturers have consolidated in an effort to keep pace with their retail and foodservice customers. And many that supply goods or services to food manufacturers – such as farmers, equipment or ingredient suppliers – have also consolidated. We see the same trends in the healthcare, financial services, pharmaceutical, telecommunications, airline, banking, automobile manufacturing and high-tech industries.

Consolidation in the meat industry is a reaction to intense competition and marketplace realities. It is not – as some would lead you to believe -- some sinister plot in and of itself. Tough competition in the meat industry is driving businesses to operate more efficiently and more aggressively than ever before. And sometimes, that has meant that businesses choose to merge or to acquire or to be acquired in order to stay in business.

Mr. Chairman, today's business and investment community views mergers and acquisitions as generally good developments, because they help sustain or strengthen businesses, they preserve jobs and many times they keep communities financially healthy. Let's face it – it is better for a struggling meatpacker to merge or be acquired, and stay in business, than for that company to cease operations, leave production contracts unfulfilled and release all of its employees. This is especially true in smaller, rural communities, where a meatpacking company may be one of the community's larger employers.

Against this economic backdrop, AMI's Board of Directors strongly opposes legislation that would create new and different premerger review processes and antitrust enforcement procedures for the agribusiness sector. We would urge your committee not to support legislative efforts that would unfairly single out the agribusiness community for different antitrust enforcement from the rest of the business community.

AMI's members have one common objective: to produce products consumers will buy. It is the consumer who determines the value of our products, which in turn determines the value of our raw materials. So any discussion starts with the consumer. Market research tells us that U.S. consumers have diverse tastes and that 95 percent of them eat meat and poultry regularly, so there is room in the marketplace for many different meat and poultry products with many different attributes. We also know that there is a robust global appetite for U.S. meat and poultry products. We now export 9.3 percent of our beef products and 6.9 percent of our pork products, principally to Japan, Mexico and Canada. These exports have grown exponentially in the past decade, in large part because we produce what consumers abroad want to buy.

Over the last three decades, Americans have benefited from increasing meat industry efficiency that has made meat more affordable, abundant, convenient and varied. Each year, consumers spend less of their disposable income on meat and poultry. Today, that number stands at 1.9 percent, compared to 4.1 percent in 1970. This is a trend of which we are proud – and one that provides consumers a distinct benefit. We should not rush to undo the foundations of this success without understanding the ramifications for everyone involved.

Exports hold the key to the future growth and viability of the U.S. livestock and meat industry. In fact, it is clear that the export market will be the primary engine of future growth in our industry. Regardless of whether we like it, the long-term viability of the sector depends on our ability to compete in world markets. U.S. exporters struggling for a share of many of the promising, newly invigorated markets in the Far East are facing ferocious competition from Canadian, Australian, New Zealand, Danish and Argentine meat marketers. To the extent the U.S. government adopts policies that increase the regulatory burden on U.S. meat producers and processors or impede structural adjustments that promote efficiency, U.S meats become more costly and less competitive in foreign markets and we risk losing all-important market share.

In fact, livestock producers have raised and spent hundreds of millions of dollars over the past decade through check off programs intended to build consumer demand for beef and pork. A large part of these efforts has been to send clear signals from the consuming public back to producers, so that producers can deliver the type of livestock that will yield the meat products most in demand. These efforts have had many benefits, including improved communications throughout the meat chain among retailers, packers and producers. This, too, has led to vertical integration.

Leaner Value-added Beef and Pork Products for Consumers. Retailers, meat packers and livestock producers heard loud and clear in the 1980s that consumers wanted leaner meats. Working together, these three sectors accomplished an average 27 percent fat reduction in a serving of beef and a 31 percent fat reduction in a serving of pork. Among the actions taken were: packers and retailers trimming fresh meats to ¼-inch of external fat; hog producers and pork packers working together to develop leaner hogs; cattlemen and meat packers petitioning USDA to create a new "Select" grade for leaner beef; and meat processors developing vast new offerings of low-fat hot dogs, luncheon meats, ham, sausage and bacon products. Increased coordination among producers and packers has provided for greater information exchange, helped improve herd management, and aided producers to deliver livestock at the optimum time, which are all essential components that have assisted in producing a leaner, more competitive product.

Improved Risk Management Options for Producers. The volatility inherent to farming and ranching has been reduced for many livestock producers through the increased use of contracted sales with meat packers and many other creative risk management plans. The benefits to farmers were perhaps most vivid during the hog market crash of 1998, when spot market prices for an unanticipated over-supply of hogs dropped to as low as $9 per cwt. Those hog farmers with contracts had locked into much higher prices for their hogs – generally $35 and more per cwt. – and were protected from the low market prices. Packers with contracts, on the other hand, were obviously paying far over the market value for their hogs at the time. Both parties to the contract, however, benefited from the certainty provided by a steady, consistently priced, and contracted supply of hogs.

Market Access for Young Producers. During the past decades, the average age of livestock producers has been steadily increasing. This is of great concern to the packing community, which is dependent on reliable supplies of quality inputs at affordable prices. Contracting options, marketing agreements, and other producer-packer arrangements provide a means for young producers to access the capital necessary to continue on or enter the livestock production business. Many young people have the educational background and herd management knowledge necessary for this business but lack the ability to enter because of the capital requirements. Arrangements between producers and packers assist in retaining the valuable herd management knowledge in production agriculture.

Economic Investment in Rural America. A majority of AMI's members operate their plants and facilities in towns with populations under 100,000. The economic value and employment generated from our member's operations are significant economic drivers in hundreds of small and mid size communities across America. An essential component to their ability to continue to employ hundreds of thousands of individuals in their facilities is the assurance of a reliable supply of inputs. Contractual relationships, marketing agreements and other arrangements provide a means to ensure that facilities can run at optimum levels and can make planning decisions for their daily, weekly and monthly operations. Ill-conceived limitations on the procurement process place into jeopardy the ability for plants to reasonably anticipate workforce requirements on a daily, weekly and monthly basis. Producer-processor arrangements provide a means for processors to adequately plan workforce needs.

The benefits of coordination and even integration between manufacturers and their suppliers in the meat industry are clear. Indeed, this is a trend throughout the manufacturing and service economy. It is driven largely by consumer demand for consistent product quality at the lowest possible price. The demand for low prices has led to fewer and larger retail chains in fields as diverse as home improvement products (Home Depot), video rentals (Blockbuster), food and consumer products (Wal-Mart) and fast food (McDonalds). These companies not only owe their success to these qualities and business practices, they advertise them to consumers. The consolidation at the retail level has driven consolidation at the manufacturer level – for tools, appliances, consumer goods and food products, among others. The demand for consistent product quality has led many firms to exert greater control over their supply chain. Just ask anyone who supplies products to Wal-Mart or McDonalds what that means: it means you must meet their standards or you can't sell to them. It often means you must subject your products and plants to periodic customer audits. This is the way business is done today – and the meat industry is no exception.

Against this background, I am sure you can understand why the American Meat Institute strongly opposes efforts that would make it illegal for meat manufacturers to do what the rest of the global business community is doing, forming relationships with suppliers of raw materials in order to produce consistent quality, low priced products that consumers want to buy. In our view, the proposed ban on packer ownership, control or feeding of livestock would do just that. Further, we will oppose any effort to restrict meat packers who comply with antitrust and fair business practice laws from sourcing their raw materials in any way. It is unfair to make it illegal for the meat industry to compete with the poultry industry or any other industry for the consumer's dollar without the same rules applying to all.

We should remain focused on the fact that we are participating – or attempting to participate – in a global marketplace. Misguided decisions, intended to benefit one segment of the industry, could easily backfire to the detriment of the entire industry if such actions have the ultimate effect of pricing our meat products out of international markets.

Chairman Dewine and members of this subcommittee, I urge you not to single out the agribusiness community for a different approach to premerger reviews and antitrust enforcement. Thank you for the opportunity to appear before you today.

Consumer Federation of America

July 22, 2003

The Honorable Mike DeWine
Chair, Senate Subcommittee on Antitrust, Competition
and Business and Consumer Rights
SD-161 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator DeWine:

The proposed sale of Farmland Industries' pork processing business to rival Smithfield Foods is extremely troubling. It presents clear problems for consumers and should be rejected.

With annual sales of $8 billion, Smithfield is the leading pork producer in the nation. It alone controls almost 20 percent of the market. Seventy-four-year-old Farmland, now in bankruptcy, is the nation's sixth-largest pork producer, with annual revenue of $1.8 billion. If approved, this acquisition will create a pork processing mega-firm that will control nearly 30 percent of the market.

Since the mid-1980s, there has been general agreement that, if four firms control 40 percent of a market, that market is no longer competitive. In this case, four firms *already control about 60 percent* of U.S. hog slaughter, prompting ongoing concern about the state of competition in pork processing. Approving Smithfield's acquisition of Farmland will send that number noticeably higher. When the dust settles, *the top three pork processing firms could control as much as 70 percent of the market.*

Individual mergers and acquisitions can trigger economies of scale that lower consumer prices and produce other benefits. The Agriculture Department has said that the largest hog and cattle plants can deliver meat to buyers at costs of up to five percent below those of smaller plants.[1] But a small number of firms dominating any one industry can also lead to higher prices. At some point, there is simply not enough competition to prevent cooperation among the major firms. The result inevitably is escalating retail prices. When acquisitions on the scale of the $363 million Farmland purchase are proposed, the merits of any expected benefits must be balanced against the dangers of creating—or worsening—a noncompetitive market. Regardless of any short-term benefits, when too few companies dominate, the longer-term result for consumers is negative.

[1] From *Consolidation in U.S. Meatpacking*, USDA Economic Research Service, February 2000

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A look at U.S. pork prices over time suggests this market is already too concentrated. Consumers are simply paying more than they should for pork products. Over the last 10 years, for example, while food price increases generally have been moderate, the price of bacon has surged 75 percent.[2] That's more than 50 percentage points ahead of inflation.

The attached line graphs[3] track farm, wholesale and retail pork prices over 25 years. As the trend lines in the first graph indicate, retail and wholesale prices diverged throughout the period, while farm and wholesale prices diverged from the early 1990s on. Coincidentally, or perhaps not so, 1992 marked the end of a major period of consolidation in pork and beef processing.[4] When the farm price of pork collapsed in the late 1990s, consumers saw little benefit. Retail prices dipped briefly and then resumed their assent. Over the 25-year period, consumers should have enjoyed flat or, at worst, modestly rising prices. Instead, the farm-to-retail price spread for pork rose a full 30 percentage points beyond inflation.

The remaining two graphs show pork price spreads *after* adjusting for inflation. The picture here is equally troubling. Based on the trend line, the wholesale-to-retail spread—the difference between wholesale and retail pork prices—increased throughout the period. What about the difference between the farm and wholesale prices? Here the spread *declined dramatically* from 1977 to the early 1990s, reflecting efficiency gains often touted by meat packers.[5] But once again in the early 1990s, at the conclusion of the consolidation period, the farm-to-wholesale spread turned noticeably award. The total spread, farm-to-retail, declined through the 1980s, again reflecting the processors' efficiency gains. As a result, retail prices fell after taking into account inflation. But then the picture changes. From early 1990 on, the farm-to-retail spread increased about 25 percent—41 cents per pound in today's dollars—*after* adjusting for inflation. Despite stagnant or declining farm prices overall, consumers saw price increases at the meat counter well in excess of inflation. These are classic characteristics of an over-concentrated market.

With this as a backdrop, the last thing consumers need is another major consolidation in pork processing. Farmland apparently needs a purchaser for its pork division. It appears to be selling off its major businesses. The problem is not that Farmland wants to sell. The problem is who proposes to buy. A purchase by Smithfield will further concentrate an already dangerously concentrated market—one in which consumers are already being harmed.

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[2] Based on retail price data from the Bureau of Labor Statistics, analyzed by Consumer Federation of America

[3] Based on USDA pork price data, analyzed by Consumer Federation of America

[4] From *Consolidation in U.S. Meatpacking*, USDA Economic Research Service, page 37

[5] A major contributor to these efficiency gains was the substitution of nonunion immigrants for unionized workers. *Consolidation in U.S. Meatpacking*, USDA Economic Research Service, page 15

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The solution is obvious. Farmland simply needs to find a smaller, less market-dominating buyer. Consumer Federation of America[6] looks forward to working with all concerned to see that the Smithfield proposal is rejected and a more suitable purchaser is identified.

Sincerely,

Arthur S. Jaeger
Associate Director

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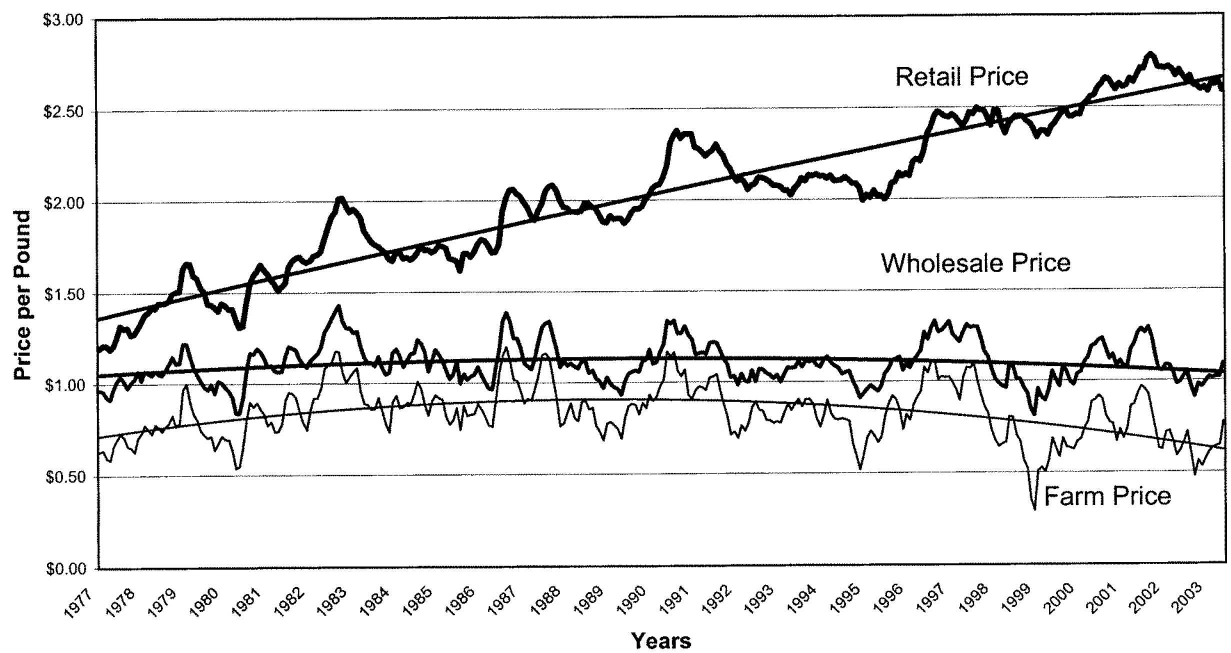
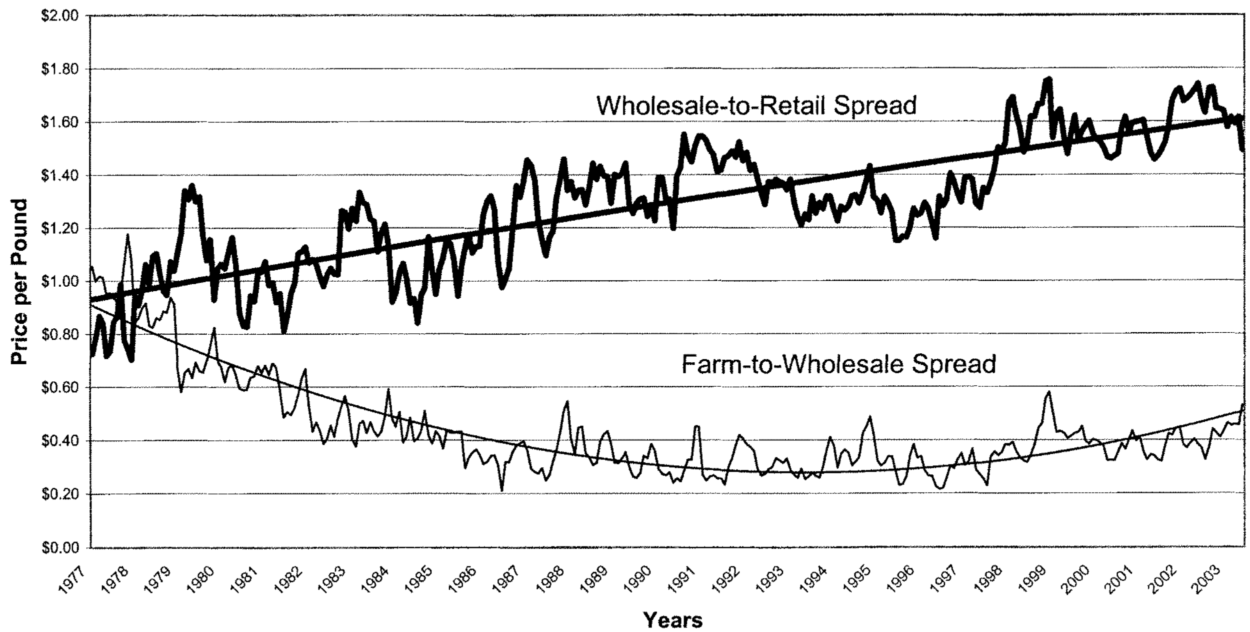
[6] CFA is an association of approximately 300 pro-consumer organizations formed in 1968 to advance the consumer interest though advocacy and education. CFA's positions are determined by its 300 member groups, who vote on them in annual meetings, and by its elected board of directors.

Figure 1: Farm, Wholesale and Retail Pork Prices, 1977- 2003



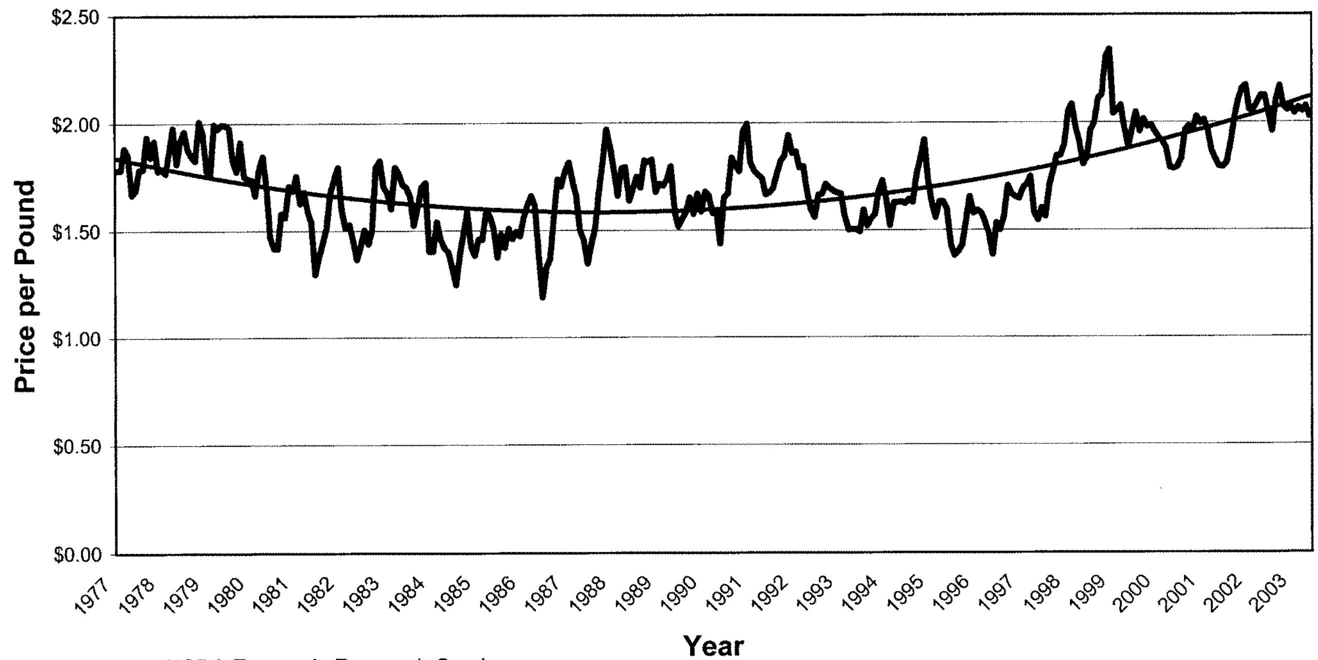
Source: USDA Economic Research Service
All values retail equivalents
Prepared by Laura Nieskens, Consumer Federation of America

Figure 2: Wholesale and Retail Pork Price Spreads, Adjusted for Inflation, 1977-2003



Data Source: USDA Economic Research Service
Prepared by Laura Nieskens, Consumer Federation of America

Figure 3: Farm-to-Retail Pork Price Spread, Adjusted for Inflation, 1977-2003



Data Source: USDA Economic Research Service

Prepared by Laura Nieskens, Consumer Federation of America

Statement of U.S. Senator Russ Feingold

Senate Judiciary Committee
Subcommittee on Antitrust, Competition Policy and Consumer Rights

HearingOn Agricultural Consolidation

I want to thank the Chairman for holding a hearing on such an important issue. Increased consolidation and market concentration are, without question, prevalent concerns for producers throughout the nation. As I travel around my home state of Wisconsin, this issue is raised by farmers and growers on a consistent basis.

I am greatly concerned that industry trends toward consolidation and concentration are causing great disruption, and sometimes ruin, for our nation's small and medium sized producers. Consolidation of our agricultural industry is not the sole cause of the low commodity prices farmers get from processors, but the trend toward agribusiness mergers and acquisitions certainly contribute to this problem. Farmers are rightfully troubled by inadequate market access, price discrimination against the small, independent producer, and loss of negotiating power for the men and women producing the product. And consumers are not seeing any decreases in the price they pay at the grocery store for these products.

I am pleased to be an original cosponsor of the Fair Contract for Growers Act of 2003, which was introduced to provide greater fairness in the arbitration process relating to livestock and poultry contracts. It is necessary to rectify the injustices our producers face with the types of mandatory arbitration clauses contained in large agribusinesses contracts.

The Smithfield-Farmland deal raises many questions and concerns with respect to increased concentration in the agricultural industry. It is my understanding that this acquisition would give Smithfield control of a significant portion of the pork processing industry in the U.S. Smithfield's vertical integration has put the company in direct competition with small, independent hog producers across the country. It is also my understanding that in 2000, Smithfield bought a pork processing plant in Dubuque, Iowa, that Farmland had closed, saying it intended to hire many of its 1,200 employees. The company later decided not to reopen the plant. While this acquisition would decrease competition in the agricultural industry, I am also concerned about the lack of benefit to consumers.

These types of actions do a disservice to the hard working men and women in the agricultural industry, and only function to increase already mounting obstacles to garner a fair price for their product.

Chuck Grassley

Statement of Senator Chuck Grassley, Judiciary Antitrust Subcommittee Hearing, July 23, 2003

Chairman Dewine and Senator Kohl, thank you for having this important hearing today. For quite some time, I've had serious concerns regarding increased consolidation in agriculture and its impact on rural America. Bigger is not necessarily better in agriculture - the family farmer is usually the most efficient producer in this sector. That's one of the reasons why I've always looked out for family farmers and independent producers to ensure they have fair access to a competitive marketplace.

My colleagues may already know that Iowa is the number one hog producing state in the nation. This premier status is due to the efficiency and productivity of independent producers operating in open market conditions. However, hog markets are being affected by expanded packer ownership of hogs. Further, issues like exclusive contracting and captive supply are impacting the ability of these producers to compete. More and more of these smaller producers tell me that they are finding themselves shut out of fair and open markets.

Over the last few years I've introduced or cosponsored a number of bills to address competition issues. Legislation like the packer ban, the elimination of mandatory arbitration, and the transparency act which requires a 25% spot market purchase by the packers. These bills are specifically designed to improve competition and help guarantee that producers were treated fairly by packers.

On a side note, I hope that the Judiciary Committee has the opportunity to address my legislation, S. 91, which eliminates mandatory arbitration clauses from poultry and livestock contracts in the near future. This legislation is nearly identical to the bill we passed for car dealers last Congress. It's an important issue and we should try to address it as soon as possible.

While the legislation I've introduced in the past is very important, the specific transaction we are about to discuss in this hearing is at the moment a much greater concern and priority to me. This transaction is particularly problematic for many farmers across my home state and the country. Farmers cannot fathom how Smithfield, which is clearly the largest and fastest growing integrator could possibly be allowed to purchase Farmland's hog operations.

Both Smithfield and Farmland are enormous influences on the hog market and among the top hog producing companies in the United States. This acquisition would have a serious adverse impact on hog markets in Iowa. Moreover, Smithfield has made its intention very clear that it intends to continue purchasing its competitors to assert the company's dominance in the pork industry. These are not signals I would like to see coming from any business with sizable control in both production and processing of a product.

I have very strong reservations about this proposed transaction and the continued trend in concentration in the pork industry. I've written to the Antitrust Division to urge a careful review of this proposal, and to consider thoroughly the projected impact on independent producers. This is an issue of extreme importance to a vital economic and social mainstay of my state of Iowa and indeed of our nation - I believe that the independent producer has much to lose if this transaction were to go through.

Tom Harkin

STATEMENT OF SENATOR TOM HARKIN
AGRICULTURAL CONSOLIDATION AND THE SMITHFIELD/FARMLAND DEAL
COMMITTEE ON THE JUDICIARY, SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS
July 23, 2003

I want to thank the Chairman, Senator DeWine and the Ranking Member, Senator Kohl, for holding this very important hearing. Increasing consolidation and economic concentration in the food and agriculture sector has critical consequences for farm families, consumers and rural communities. The announced acquisition of Farmland Foods by Smithfield Foods is only the most recent in a long line of transactions that have dramatically changed the economic structure of the food and agriculture sector of our economy.

The basis of our economic system is full and fair competition in open markets. The existence of that competition depends on having enough participants in markets and making sure those participants do not engage in anti-competitive practices. We still have a large number of farmers and producers in most commodities, and we have a very large number of consumers. It is like an hourglass, with a choke point in the middle made up of a few large agribusiness firms. That choke point is becoming narrower and narrower. Farmers and consumers alike are at the mercy of the few large firms situated between them.

The levels of economic concentration in agriculture already exceed those in most of the rest of the U.S. economy, which stabilized during the 1980s at between 40-45 percent four-firm concentration ratios in most sectors. That is the level at which economists generally believe most economies of size have been realized. In the agriculture sector, however, a large number of the most critical types of processing and merchandising are already well above these levels. Beef packing is at 81 percent and pork packing at 59 percent – and that was before Smithfield's planned acquisition of Farmland. And yet the mergers and acquisitions continue.

Independent farmers can compete and thrive if the competition is based on productive efficiency and delivering abundant supplies of quality products at reasonable prices. But no matter how efficient farmers are, they cannot survive a contest based on who wields the most economic power. As it is, farmers suffer from a gross inequality in economic strength, and as a consequence they receive lower returns than they would if the markets were truly fair, open and competitive.

This inequality is reflected in the fact that farmers' share of the retail food dollar has plummeted dramatically from 47% in 1950 to about 20 percent today. As another example, the farm-to-wholesale price spreads for pork and beef have increased very substantially in just the past few years. It is little wonder that farmers' return on their investments is far below that of food manufacturers and retail food chains.

Smithfield Foods' planned acquisition of Farmland Foods is yet another serious blow to the survival of our nation's independent pork producers. It will further consolidate an industry that is already heavily concentrated. Smithfield already controls 20 percent of U.S. pork

processing and will control 27 percent after the Farmland acquisition. With this move, Smithfield is further strengthening its power and leverage over family pork producers and its threat to fair markets for both farmers and consumers. As I said in my letter to Attorney General Ashcroft, it is imperative that the Department of Justice use its authority under the antitrust laws to give this latest Smithfield acquisition the most careful and stringent scrutiny it deserves.

The principle of fair competition in open markets is at the core of our nation's antitrust laws, which are in the jurisdiction of this Committee, and the Packers and Stockyards Act and other laws, which are in the jurisdiction of the Agriculture Committee, where I am the Ranking Member. I strongly believe that we can and must work together to push for stronger enforcement of the existing laws by Justice and USDA and to enact new legislation where it is needed.

Thank you, Mr. Chairman.

Testimony

Before the Subcommittee on Antitrust, Competition Policy and Consumer Rights

US Senate Judiciary Committee

By Will Hughes

Administrator
Division of Agricultural Development
Wisconsin Department of Agriculture, Trade and Consumer Protection

July 23, 2003

I am Will Hughes, Administrator of the Agricultural Development Division, of the Wisconsin Department of Agriculture, Trade and Consumer Protection (Wisconsin DATCP). The mission of the division is to: promote and advocate for the interests of agriculture through programs and services that support agricultural business and market development and provide assistance in responding to the rapidly changing economic environment affecting agriculture. We believe that helping create new businesses in agriculture will help both producers and consumers benefit from new products, other innovations, and healthy competition.

Thank you Chairman DeWine and members of the committee for the opportunity today to share with you perspectives from a state agency on issues related to concentration in food and agriculture. On behalf of the State of Wisconsin and its 77,000 producers, I especially want to thank Senator Kohl for his excellent leadership and representation of Wisconsin agriculture, and for his invitation to us to speak about issues related to concentration and its implications for agricultural producers.

My testimony today will focus primarily on policy issues and policy recommendations that we hope Congress will consider as it establishes national agricultural and antitrust policy.

Let me first provide you with some background on the Wisconsin DATCP. The agency is unique in its scope of authority compared to other agricultural agencies among states. Its main regulatory authorities relate to protecting consumers through safe food, animal health, natural resource protection, and prevention of unfair business practices. The most powerful law administered by Wisconsin DATCP is the "Little FTC Act" (ch. 571, Laws of 1921) which provides the department with sweeping authority to protect consumers and competition. Under that law, the department may prohibit "unfair" business practices and prescribe "fair" practices affecting consumers and competition.

Being an agricultural state[1], the consumer protection authorities vested in the department, benefits both consumers and agricultural producers. In recent years, the Wisconsin DATCP has used these authorities in some very relevant ways concerning business practices of major buyers in dealing with agricultural producers.

[1] Wisconsin ranks 10^{th} in farm cash receipts among states and first nationally in number of dairy producers, cheese production and a number of processing vegetables and specialty crops.

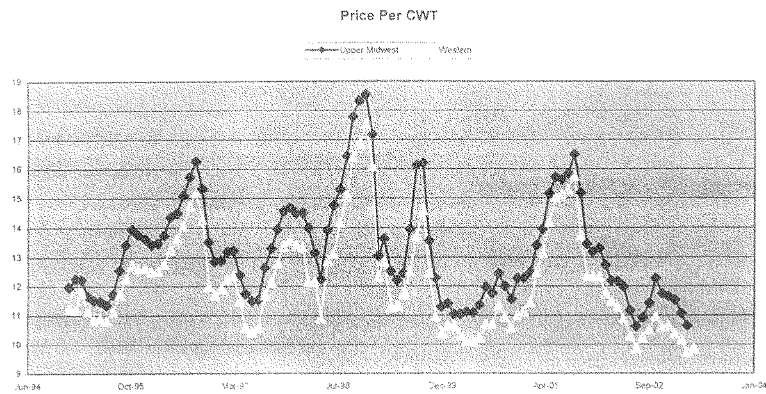
- Established rules for vegetable contractors which govern vegetable procurement practices including contracting (1992). The rules were established following a study and investigation of trade practices in the vegetable processing industry.
- Major enforcement action against price discrimination by milk buyers in purchasing milk from producers. Price discrimination in milk purchasing is explicitly prohibited under s.100.22.
- Established labeling rules for rBST-free milk to prevent deceptive or misleading labeling and advertising of rBST-free labeled milk and dairy products (1995).
- Conducted a major investigation into business practices of the National Cheese Exchange and its trading participants (1996). New administrative rules were proposed following an in-depth study and investigation, but were not adopted with the closing of the National Cheese Exchange.

In each of the above matters, Wisconsin DATCP exercised its authorities to improve competition and to protect consumers. In each case it was Wisconsin acting on its own, without help from the federal government, when in fact each of these issues were foretelling of national issues and had national implications.

But in the last decade concentration has increased rapidly, particularly in food retailing, but also in food manufacturing and marketing. The rise of Walmart to the number one position in food retailing has many implications for consumers and back through the supply chain to food manufacturers and to producers.

There are increasing concerns being expressed in the heartland by producers and consumers over these trends: 1) concerns over matters of contracting practices of major buyers across an increasing number of agricultural sectors; 2) concerns over the tendency towards increased market power due to the rapidly declining number of food manufacturing or handling firms that compete for and buy from producers; and 3) concerns over unfair trade practices that may result from greatly uneven bargaining power.

In Wisconsin we are fortunate to have remaining a fairly large number of dairy buyers actively competing among themselves for the purchase of milk from producers. There is strong anecdotal evidence that having a large



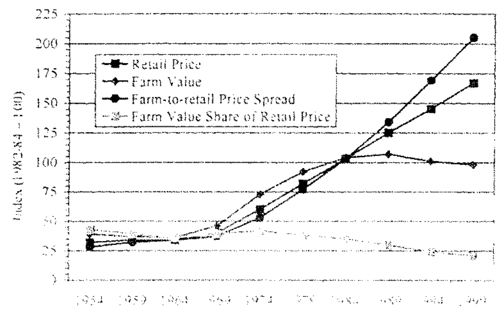
number of buyers results in higher milk prices for Wisconsin's 16,500 dairy producers. The graph above illustrates this fact. Mailbox prices paid by buyers in the Upper Midwest, where competition for a dwindling supply of milk among multiple competing buyers is high, consistently exceeds the minimum prices that are dictated by the federally regulated pricing system. Many other areas where competition for producer milk among competing buyers is low are regularly at or close to the minimum federally regulated milk prices. For example, over the past 5 years mailbox prices in the Upper Midwest have exceeded the western region by $1.03 per hundredweight. These mailbox prices illustrate the value of preserving competition in agricultural markets.

However, the trends in the dairy sector are of increasing concern in Wisconsin and other dairy states. Between 1985 and 2001 the number of dairy farms declined from 43,000 to 17,000 and the number of dairy plants in Wisconsin declined from 400 to 200. It is important to work proactively about increasing consolidation and concentration before there are only one or two buyers left in a market. In Wisconsin, we want to preserve a competitive environment for dairy producers. Wisconsin DATCP's priority is to revitalize and grow the dairy industry with diverse dairy farm production systems including grazing, facility upgrades and specialty artisan dairying.

Increased concentration up through the supply chain to retailers makes dairy renewal difficult. One ramification of concentration is to reduce business opportunities for traditional and medium sized dairies. The opportunities seem to be at the extremes for either large scale production that is attractive to larger buyers or very specialized, small scale dairying that focuses on

value adding, artisan style production. The middle sized producer and food

Measurement Framework—Price Spreads



Source: Economic Research Service (2000)

manufacturer is getting squeezed.

From the graph above on farm-to-retail spreads you can see why producers desire more of the retail value of the products derived from their commodity. However, the reasons for the trend of lower farm value and higher retail values are complex. The important issues are to help farmers who are willing and able to take the risks of adding value vertically in the supply chain and at the same time prevent the situations where market power arising from concentration exacerbates the trend lines.

We have a vision in Wisconsin to bolster our heritage of producer involvement in agricultural cooperatives by working to enhance producer-owned businesses in value-added products and markets. We are working with producers based on vision of a fellow producer in Iowa whom has a vision to market 100 percent of his production through processing, marketing and distribution businesses in which he has ownership interests. It is easy to frustrate this vision as the playing field becomes increasingly unlevel.

Wisconsin DATCP has several recommendations for your policy considerations as it relates to agricultural and antitrust policies. These recommendations include:

1) Improve and tighten coordination on antitrust and concentration issues between the US Department of Justice, USDA and states. Rather than in a reactive framework when a major acquisition or merger arises, as is currently the system, establish an on-going working group among federal and state agencies to proactively address antitrust and competition issues, to formulate policy and regulatory recommendations, and to improve coordinated approaches both nationally and internationally. It seems more logical and effective to structure an antitrust and competition approach to prevent monopolization and unfair trade practices rather than address problems after the fact.
2) Increase the funding committed to research on agricultural concentration and antitrust issues. It appears that funding commitments to research in industrial organization is grossly under-funded given these times of increasing concentration. Such research should be stepped up to help build better approaches to regulating antitrust and competition issues as well as analyzing policies that should improve competition and benefit both producers and consumers. For example, too little antitrust and competition research is being done in the highly concentrating food retailing sector or on the increasing complex strategic alliances among formerly competing businesses. While there are no simple categorical answers to the impacts of these arrangements, there ought to be the light of good research shed on them.
3) Continue and increase programs and funding for the development of producer owned businesses in value added agriculture. For the first time in decades, the US has begun to positively support the development of producer owned businesses. Cooperative development grants and cooperative research, as well as launching the new value added agricultural development grants have been positive new program and funding developments. It is important to continue and increase funding for these programs to help stimulate innovation and diversification in the food business so that producers and consumers can benefit.
4) Strengthen competition by authorizing the interstate shipment of state-inspected meat and poultry products. For decades there has been a federal prohibition on interstate shipments of state inspected meats while there is clear evidence that most of the 28 states with state inspection programs are "at least equal to" the federal inspection program. Wisconsin has nearly 300 state inspected meat plants many with thriving in-state businesses. If we are truly committed to fostering competition in the meat business in a positive manner, while protecting food safety, allowing these meats to be shipped interstate should not be a question.

5) Ensure that producers have continued ability to bargain for fair prices for their production and for fair terms of trade. There are federal protections for agricultural producers, including the Capper-Volstead Act, that allows producers to bargain for or establish prices and other terms of trade. These protections are increasingly important as producers look at new and innovative ways to obtain a more level position in market power while the supply chain around them consolidates. This does not mean that producers should have cart blanche with their business practices.
6) Ensure transparency of pricing for agricultural commodities. As contracting and other less public trading arrangements evolve it is important to develop new methods for price discovery and for price transparency.
7) Ensure that clear standards are established concerning business practices and for mergers and acquisitions so that a more public role is taken to ensure fairness for both producers and consumers.

There clearly needs to be consistency and coordination between agricultural policies on the one hand and antitrust and competition policy on the other. It is ironic for federal farm policy to provide direct payments to producers on the one hand, and to help producers build new value added food businesses, when antitrust and competition policy may be frustrating those efforts. It is also important to work both offensively to help stimulate innovation and diversification in the food sector, as we believe especially in producer owned businesses, and to also work defensively to establish rules and policy frameworks that prevent injury to producers and consumers that may result from over-concentration.

Thank you for the opportunity to share these perspectives.

National Farmers Union

Testimony of Mr. Russ Kremer
Missouri Farmers Union President

On Behalf of National Farmers Union

Before the
U.S. Senate Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights

Wednesday, July 23rd, 2003
Washington, D.C.

STATEMENT OF MR. RUSS KREMER

PRESIDENT, MISSOURI FARMERS UNION - ON BEHALF OF NATIONAL FARMERS UNION

HEARING BEFORE THE U.S. SENATE JUDICIARY SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS

PROPOSED PURCHASE OF FARMLAND FOODS PORK DIVISION BY SMITHFIELD FOODS

JULY 23, 2003

Thank you Chairman DeWine and Ranking Member Kohl for the opportunity to testify before this subcommittee on agriculture concentration and the proposed sale of Farmland Foods pork division to Smithfield Foods. I am Russ Kremer, president of the Missouri Farmers Union and am here today to testify on behalf of the National Farmers Union.

I've been involved in independent pork production since I was a child in a county that, for many years, led our state in the number of independent pork operations. However, during the past five years, we've seen our marketing opportunities, and therefore our profit opportunities, dwindle dramatically. Market choices during that time have declined from five to two. The potential acquisition of Farmland by Smithfield Foods threatens to reduce that number to one. Without competitive bids and fair market prices, another large exodus of family farmers from the pork industry is likely to occur. Many of our local communities that once enjoyed a sustained economy due to the circulation of revenue from independent pork farms and community-based businesses will continue to experience serious decimation.

Inadequate market competition is a top concern and one of the most pressing issues for independent farmers and ranchers across America. The trend toward horizontal and vertical integration in the agriculture and food sectors does not allow independent producers to succeed without protection from unfair and anti-competitive practices. Due to these concerns, National Farmers Union has commissioned three studies in the past five years on the impacts of agricultural and retail concentration and related barriers to farmer-owned business. I ask unanimous consent that these three studies be inserted into the record.

The Farmers Union strongly supports public policy that ensures competitive and open agricultural markets. Unfortunately, current antitrust laws, written in the early 20th century, have not evolved alongside the rapidly changing infrastructure of production agriculture. The increased market power of processing and production firms has had a negative effect on the economic returns and market opportunities of independent producers. The studies we have commissioned, demonstrate vertically and horizontally aligned companies abusing their market power, with both producers and consumers paying the price. Today's agribusiness firms are

showing record profits, while at the same time farmers and ranchers are struggling to survive and consumer food costs continue to rise.

We are here today to discuss the potential acquisition of Farmland Foods pork division by Smithfield Foods and the competitive market implications of the proposed sale. The loss of our nation's largest farmer-owned cooperative is not only devastating to America's independent agricultural producers, but also furthers the goal of Smithfield Foods to gain greater control of the pork production and processing sector. If this sale is approved by the U.S. Bankruptcy Court in Kansas City and the U.S. Department of Justice, Smithfield Foods will control twenty-seven percent of the pork processing industry. The top four pork processing firms-Smithfield, ConAgra, Tyson/IBP, and Cargill will now control sixty percent of the market, up from thirty-seven percent level in 1987,

Smithfield raises twelve million of the twenty million hogs slaughtered in their processing plants on a yearly basis. The addition of Farmland's 36,000 sows will increase Smithfield's sow inventory to approximately 800,000. This is three times the number of sows owned by the next largest pork producer- Premium Standard Farms. Not only is Smithfield aiming to acquire Farmland, the company is also currently engaged in negotiation with Alliance Farms Cooperative Association, which has a total of 27,500 sows. In 1994, the Smithfield sow inventory totaled approximately 65,000. In less than ten years, this single company has managed to increase its ownership of sows twelve-fold through acquisitions and mergers such as the one begin discussed today. To allow this proposal to be approved prior to Congress conducting a thorough review to ensure anti-trust laws are adequate, would be like shutting the gate after all the pigs get out.

Smithfield officials have indicated that if the proposal is approved, they would continue to operate and maintain production levels at all Farmland plants. What has been left unsaid is the fate of the other plants purchased by Smithfield via previous acquisitions and mergers that may now be determined inefficient. Employees of these plants will be put out of jobs, local producers will be left with fewer market opportunities and the communities will be responsible to clean up the mess left behind.

History has shown that when a large firm acquires competition, the resulting concentration of market power reduces access to and transparency of local and regional markets for producers. Given Smithfield's propensity to own a sizeable share of its slaughter hogs, the market impact of this merger will likely diminish economic opportunity for producers, compared to a merger of similar scale where a firm purchased its hogs from independent suppliers. I believe producers in my state and across the country will be further faced with lack of buyers and a competitive price for their hogs as a result of this proposed acquisition.

Although contract production is often touted as a viable opportunity and risk management tool for farmers, without contractor competition in the region, the contractee has little bargaining power when its time to renew that five or seven year contract. The farmer often finds himself in a "take it or leave it position."

Concentration of the agriculture and retail food sectors has, in many instances, discourages the growth and development of smaller, farmer-owned, value-added cooperatives. As president of Ozark Mountain Pork Cooperative, a new generation cooperative that processes and markets pork from member-owned hogs, I have witnessed many challenges to accessing the marketplace because of market concentration and power. Large conglomerates often have tight control of brokers, retailer distributors.

The loss of family farms and other independently owned businesses is not inevitable. The National Farmers Union believes there are a number of reforms that can originate within this subcommittee to ensure fairness, transparency, protection and bargaining rights for producers, which would restore and enhance competition for agricultural markets.

*We support implementation of a temporary moratorium on large agricultural mergers. The moratorium is necessary to provide Congress with time to review current law and strengthen it as appropriate to restore market competition for producers and consumers.

*Congress should require USDA to collect and publish concentration information.

*The Justice Department (DOJ) and the Federal Trade Commission (FTC) should require firms to submit information on joint ventures and alliances among firms that account for a significant percentage of market share at a regional level. In many cases, firms that are participating in joint venture arrangements behave just like firms that have merged and should be subject to the same level of antitrust scrutiny as mergers.

*Congress should require DOJ and the FTC to detail the factors which mitigate the anti-competitive effects of a merger subject to antitrust review, if the decision is made not to oppose the merger. This would improve accountability.

*Congress should expand the role of USDA to initiate and/or participate in the review of proposed mergers in the agricultural sector and require an economic impact statement be provided detailing the impact of a proposed merger on farmers and ranchers prior to approval.

*An Office of Special Counsel on Competition should be established within USDA to streamline and increase the effectiveness of USDA investigation and enforcement of competition laws.

*A specific level of concentration should be established that triggers a presumption of a violation of antitrust law to make it easier for the DOJ and the FTC to identify and prevent high levels of anti-competitive market concentration.

*Congress should pass legislation that repeals the effect of the Illinois Brick decision and would allow farmers and ranchers to hold retailers responsible for anti-competitive market activity. Farmers and ranchers cannot sue retailers due to a legal precedent set by Illinois Brick, a case where the court held that farmers and ranchers have no legal standing for recourse against retailers since they do not deal directly with retailers. As the retailers gain more and more power within the marketplace, it is vital that they should be liable for damage they cause due to market manipulation.

*Congress should prohibit slotting fees, i.e., the fees charged to suppliers to put their product on the store shelf. Slotting fees provide windfall profits to retailers and create a barrier of entry for new firms and products, which encourage further accumulation of market power among a limited number of processors and food manufacturers.

*Congress should pass contract reform legislation to enhance fairness and provide producers protection in their agricultural production contracts. This legislation should contain:

1. Contracts to be written in plain language and disclose risks to producers
2. Provide contract producers with a first-priority lien for payments due under contracts
3. Prohibit producers from contract termination out of retaliation; and
4. Make it an unfair practice for processors to retaliate or discriminate against producers who exercise rights under the legislation.

Thank you, Mr. Chairman, for the opportunity to testify today and for holding this important hearing. We look forward to working with you in this subcommittee and the entire Congress to strengthen antitrust laws, foster a transparent and fair marketplace for all producers. I welcome the opportunity to answer any questions committee members may have.

Statement of Senator Patrick Leahy,
Subcommittee on Antitrust, Competition Policy, and Consumer Rights
Hearing on "Agricultural Consolidation and the Smithfield/Farmland Deal"
July 23, 2003

Mr. Chairman, I want to thank the Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights for holding this hearing on agricultural consolidation. The rapid consolidation we have witnessed in almost every sector of the agricultural industries over the past decade has had a tremendous impact on the lives and livelihood of American farmers. It affects producers of most commodities in virtually every region of the country.

In my own state of Vermont, agriculture is certainly a significant industry, and in Vermont dairy is king—accounting for roughly three-quarters of the State's net farm income. For decades dairy farmers seemed immune from the consequences of restructuring because, through their cooperatives, they also served as milk processors for their local or regional markets. National markets did not exist. That structure has changed dramatically over the past three years. As a result, our farmers are not getting a fair share of the retail price of milk, while giant, corporate processors are raking in anticompetitive profits as they raise prices to consumers.

My major concern in New England relates to Dean Foods, Inc., which merged with Suiza Foods in 2001 to form the largest milk processing company in the world. I was surprised and disappointed when the Justice Department's Antitrust Division approved this merger, because the new company now controls almost 70% of the milk supply in New England. It achieved this market dominance by buying up local dairies and then closing them down.

Moreover, Dean Foods now controls over 30 percent of all milk production nationally, in addition to having strategic alliances with other entities that expand its influence even further. Dean Foods has an alliance with Dairy Farmers of America (DFA), a massive cooperative now representing 22,000 dairy farmers in 43 states. DFA was formed in 1998 through the mergers of a number of cooperatives, including Mid-America Dairymen, Milk Marketing Inc., and Western Dairymen Cooperative. DFA also owns Borden Foods. Dean Foods also has an alliance with Land O'Lakes, which was recently expanded to include a new licensing arrangement that grants Dean Foods a perpetual license to use the Land O'Lakes brand name nationally on a broad range of fluid milk and cultured dairy products, including all basic fluid dairy products, as well as a variety of other value-added products. Sales through these inter-locking deals between Land O'Lakes, DFA, and Dean Foods total over $12 billion annually.

More recently, I have been concerned about last year's proposed merger between H.P. Hood Inc. and National Dairy Holdings, which is why I led a bipartisan group of 10 U.S. Senators in asking the Justice Department's Antitrust Division to investigate the merger. H.P. Hood, a New England icon, attempted to acquire the much larger National

Dairy Holdings from Dairy Farmers of America and other investors. DFA owns a controlling interest in National Dairy Holdings, which was created as a spin-off in the Dean Foods/Suiza Foods merger. As a condition of the sale, DFA would have had an exclusive right to supply milk to all H.P. Hood plants -- including those currently supplied by other dairy cooperatives, such as Agri-Mark. DFA has similar exclusive-supply agreements with Dean Foods and other fluid milk processors. This merger would have allowed one company -- DFA -- to control more than 90 percent of the New England fluid milk supply, with exclusive supply agreements with both Dean Foods and Hood Milk.

Fortunately, as a result of government antitrust scrutiny, H.P. Hood withdrew its original plan to merge with National Dairy Holding in May. While the merger is being restructured, we continue to be in a position where a handful of affiliated firms control access to a majority of the markets for milk in this country. Opportunities for dairy farmers to market their milk independently have been all but eliminated. In addition, two cooperatives now control access to most of the nation's processing facilities and are using this access to expand further. This is not good for dairy farmers, it is not good for other market participants and in the end, and it is not good for consumers.

As dairy farmers continue to suffer from record-setting low milk prices, Dean Foods is recording record-setting profits. In May of this year, Dean Foods reported a record first quarter profit, $93 million over the first quarter of last year, largely due to plummeting milk prices paid to farmers. In most competitive markets this could not happen. In a competitive market, when input costs fall, competition tends to drive consumer prices lower, thus ensuring that manufacturers do not realize windfall profits. But not so in the dairy industry—retail prices for fluid milk are virtually unchanged this year, even though prices farmers receive for their milk have fallen nearly $.50 per gallon in the last 18 months.

I continue to believe that the Justice Department and other government agencies should investigate why lower farm prices for milk have not been passed on to consumers. That is why I have asked the watchdog agency of Congress – the General Accounting Office – to investigate the widening disparity between farm and retail milk prices that has caused such financial hardship for northeast dairy farmers.

This is just the most recent of my efforts to establish greater protections against market abuses by powerful agribusiness interests. In 1989, I asked for a Federal Trade Commission investigation and authored legislation, which became law, to impose massive fines on manufacturers of infant formula for anticompetitive behavior. In 1992, I authored legislation, which became law, to bar companies convicted of school lunch milk price fixing from participating in the school lunch programs.

Last year, I co-sponsored legislation with Senator Daschle and 14 of our colleagues to enhance fair and open competition in the production and sale of agricultural commodities. Our bill, S. 20, strengthened laws prohibiting anti-competitive activities currently in the Packers and Stockyards Act by broadening their scope to protect

producers of *all* commodities (rather than only covering cattle, hogs, and sheep) and adding provisions related to price discrimination, whistle blower protection, and limitations on the use of "right of first refusal" contract provisions. Among its many provisions, it expanded the standard of review for mergers and acquisitions to include impacts on rural communities—similar to the manner in which the Surface Transportation Board and the Federal Communications Commission consider other factors when reviewing railroad and telecommunications merger proposals.

During the farm bill, I also supported bipartisan efforts led by Senator Tim Johnson and Senator Charles Grassley to ban the ownership of livestock by meatpackers for more than 14 days prior to slaughter. Unfortunately, the packer ban provision was killed by House conferees while the farm bill was negotiated in conference committee last year.

As the farm bill debate demonstrated, powerful interests are opposing our efforts to provide free and fair markets for all agricultural producers. And so, I look forward to the testimony of today's witnesses as we continue to seek new ways to address these problems, and improve market opportunities for America's farmers and ranchers.

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Public Citizen

Joan Claybrook, President

July 23, 2003

Senator Mike DeWine, Chairman
Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights
SD-161, Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman DeWine:

On behalf of Public Citizen, I am writing to oppose the Smithfield Foods, Inc. acquisition of bankrupt Farmland Industries' pork processing business.

As you know, Public Citizen is a non-profit consumer advocacy organization that was founded in 1971 by Ralph Nader. We represent some 150,000 members nationwide.

We oppose the merger of these two companies for a number of reasons.

- This purchase is bad for consumers, in that it places upward pressure on wholesale/retail pork prices, and for farmers, in that it will cause lower prices for family farmers.

- Consolidation in the pork processing industry is already at all-time highs.

- Consolidation at both the retail and processing levels has resulted in processors and retailers widening their gross profit margins at the expense of consumers and producers. Farm to wholesale spreads have increased by about 33% in 7 years. Wholesale to retail pork price spreads have increased by 23% in 7 years. This is inflation-adjusted and based upon data furnished by the United States Department of Agriculture.

- This drastic increase in per unit profit margins has come from pushing

producer prices downward and pushing retail consumer prices upward. In a competitive market, the per unit profit margins would remain stable because no firm could push prices up due to the competition. This means the market is not working; rather excessive market power is at work.

- Further consolidation will only accelerate this trend. There is no reasonable argument to be made that this deal will help farmer prices or consumer prices.

Consumers would not be served well with this merger, and we urge the Congress to use its influence to block its consummation.

Sincerely,

Wenonah Hauter, Director
Critical Mass Energy and Environment Program

Testimony of Joseph Sebring
Before the Antitrust Subcommittee of the U.S. Senate Committee on the Judiciary
July 23, 2003

Thank you Mr. Chairman, and Senator Kohl for the opportunity to appear here today to share the view of John Morrell and Smithfield Foods about the best course for federal policy with regard to the structure of the meatpacking industry, and, to briefly answer some of the questions you and your colleagues may have about the pending acquisition of certain assets of Farmland Foods by Smithfield Foods.

I am Joe Sebring, President of John Morrell, an Ohio based company that produces processed meats and fresh pork. John Morrell is a wholly owned and independently managed subsidiary of Smithfield Foods. John Morrell & Co. owns four subsidiary companies: Curly's Foods, Iowa Quality Meats, Mohawk Packing Company, and Saratoga Specialties. John Morrell and Smithfield are part of the great American agricultural tradition of producing the highest quality food in abundance to feed our country and the world. Many of us at Smithfield companies come from families where the traditions of the farm and the land are deep, and we hope that you will keep that in mind as you make decisions about our company and our industry, and the farmers and ranchers who work with us every day.

This hearing and much recent debate is about vertical coordination and how much vertical coordination should be permitted. Since the days of Teddy Roosevelt there has been consensus in our country that vertical coordination should be permitted until it goes too far. When it goes too far, we have in place nearly a century's worth of laws that provide the means for our government to rein it in. Our company and our industry are already subject to the restrictions on anticompetitive practices contained in the Sherman Act, the Clayton Act, the Robinson-Patman Act the Federal Trade Commission Act, many state laws and key provisions of the Uniform Commercial Code. We are happy to live by those rules, as others do, and even to comply with another law that applies only to our industry: the Packers and Stockyards Act. That law is designed to prohibit meat packers from engaging in business practices that are unfair to their livestock suppliers. We believe that is regulation enough, that there is ample capacity for enforcement of those laws and that there is no reason to place even more restrictions on our industry that are not applied to others who are competing in the global economy. A ban on packer ownership of hogs would be devastating to our industry and to those who contract with us to supply hogs.

Smithfield and Farmland

Smithfield has made a bid to acquire certain pork production and processing assets of Farmland Foods, a division of Farmland Industries. Farmland and its Official

Committee of Unsecured Creditors and Official Committee of Bondholders chose Smithfield as the "stalking horse" bidder after conducting an extensive marketing process with other potential acquirers, and after considering reorganizing the company around Farmland Foods. The Official Committee apparently concluded that the Smithfield transaction provides the greatest opportunity to generate the highest available value to creditors, in addition to offering security and stability to the employees, independent hog producers, customers and communities of Farmland Foods

Over $1.4 billion in aggregate claims have been filed against Farmland Industries by more than 20,000 farmers and 141,000 small businesses, as shown on a chart we have submitted for the record.. In Iowa alone, more than 420 bondholders filed claims exceeding $91 million, and claims exceeding $37 million have been filed by more than 1400 creditors. They really have waited long enough. Every day that the creditors and bondholders (who are mostly farmers) of Farmland wait for this transaction to be approved is a day their likely return is diminished.

One typical reaction to the announcement among those who are concerned about the members of the Farmland coop and their creditors came from Ron Plain, Agricultural Economist at the University of Missouri who said,

> "The important aspect of the deal for pork producers is that there will be no change in Farmland Foods operations. Smithfield has stated that all the contracts will be honored, that all the plants will be kept open, that the brand will be continued, that the management, the people, will be retained. Considering that Farmland Industries is broke and that there could have been a loss of capacity, contracts and marketing strength, this is about as perfect an outcome as possible."

Under the terms of the agreement Smithfield will honor all current Farmland Foods hog production contracts. Smithfield and Farmland Foods also will remain committed to purchasing significant numbers of hogs on the open market. In short, the acquisition should have no impact whatsoever on the farmers currently supplying hogs to Farmland, either on a contract or a negotiated basis.

All of the 6100 employees of Farmland Foods will keep their jobs, and all of the Farmland Foods facilities will remain open at current production levels. The United Food and Commercial Workers will continue to be recognized at all of the unionized plants, and Smithfield has offered to assume the Farmland Foods pension plan. Farmland Foods will remain a stand-alone business operated by its current management, with the same entrepreneurial independence that Smithfield encourages in all of its businesses. The current Farmland Foods management team and headquarters employees will remain based in Kansas City. Smithfield will preserve and invest in the Farmland brand.

This acquisition involves pork production and processing assets, primarily Farmland's three hog slaughtering plants in the Midwest. Smithfield operates two hog slaughtering plants in the Midwest, where both companies process pork into products such as bacon,

ham and case-ready pork that is sold to wholesalers, retailers and food service companies. The processing and sale of pork products is a national, if not international business, and approximately 200 companies in the United States sell such products.

You may hear today the argument that the acquisition will somehow restrict small farmer's ability to sell their hogs at fair prices in the areas surrounding the Midwest plants of Smithfield and Farmland. That is speculation and is not supported by the facts. Smithfield and Farmland today do not compete for the same hogs, as an examination of the location of the two companies' hog slaughter facilities and buying stations will make clear. This acquisition must pass muster with the Department of Justice and we firmly believe that it will, because the hog slaughtering industry in the Midwest is not concentrated. Neither Smithfield nor Farmland (alone or combined) is remotely in a position to exert control in the Midwest for the purchase or slaughter of hogs. Smithfield and Farmland are the fourth and sixth largest competitors, respectively. Tyson will remain the largest competitor, while the second and third competitors, Swift and Excel, together will continue to be larger than Smithfield/Farmland in the Midwest.

Moreover, this acquisition should be viewed in the broader perspective of competition for animal protein to consumers. Pork competes with beef and poultry where the dominant players, such as Tyson and Cargill (which are much larger and more diverse than Smithfield) have continued to grow through acquisitions in the poultry and meat industries, where higher levels of concentration are found than in the more fragmented pork industry. The level of vertical coordination is higher in those industries as well - put simply, chicken is cheap because of vertical coordination. These circumstances, combined with the fact that food retailers and wholesalers are consolidating, puts intense pressure on Smithfield to become more efficient in pork and to expand its offerings of other meats. The driving motivation behind this acquisition is to become even more responsive to our customers' demands, and to further our aim of providing the best and healthiest products at the most reasonable price to the consumer. Smithfield's efforts actually contribute to growing the demand for pork products and, in turn, demand for the hogs of large and small farmers alike.

Smithfield tried to make this transaction into as much of a *status quo* proposal as possible, because Farmland Foods remained a sound business within the financially troubled Farmland Industries and a proposal that preserved the strengths of Farmland was therefore a sound investment for Smithfield, and more likely to gain favor with the creditors, the bondholders and the bankruptcy court. Furthermore, John Morrell has no intention to close its existing facilities in Sioux Falls or Sioux City. As a result, there will be no decrease in slaughter capacity (sometimes referred to as "shackle space") as a result of this acquisition. What's more, the Farmland facilities we seek to acquire are generally newer than Smithfield facilities, but not as well-maintained as Smithfield's, and haven't seen the levels of capital expenditures that Smithfield has made in its plants. We intend to bring those facilities up to Smithfield standards in short order.

The Demand for Quality and Stability

Our business practices are driven by the demands of the increasingly global marketplace and the demands of our customers. Our customers want consistent meat quality, ready and predictable supplies, lean, safe and healthy meat products and a fair price. That demand for quality now comes from the largest corporate customers like McDonalds and from ordinary shoppers buying food for their families. They want their meat not just to be fresh and wholesome, but also to taste and look the same every time, and to be consistently lean every time they buy our products. Fast food retailers have responded to this demand by imposing strict requirements on packers. Grocers have also begun to demand not just high quality, but consistent and predictable meats for their customers. To meet these demands from our customers, consistent feed, feeding practices, animal husbandry and genetics are the hallmarks of the Smithfield system. A business model with some level of vertical coordination is the best way to assure that these requirements are met, and therefore, the best way for us to succeed as a business. It would be fair to say that the level of coordination in our business model is determined to a great degree by the retail grocery stores and restaurants that are the largest customers for us and our competitors as well as by consumers. It is a "pull-through" model rather than a push-through model - we are pulled along by the demands of our customers and have met those demands by maintaining some level of vertical coordination.

The exacting requirements our customers place on us also are relevant to supply issues. The slightest interruption in supply is unacceptable to our customers because they typically are retailers and restaurants that rely for their success upon consistent sales. So our meat supplies must be predictable. That means that forward contracting with hog producers must be balanced by company owned animals in order to assure consistent supplies in the volatile commodities market. A degree of vertical coordination in our business model provides the certainty of supply that customers expect, but it doesn't mean that we use only hogs that we have raised. During the last two years, my company, John Morrell has bought 33% to 45% of the hogs available on the open market and Smithfield itself sells 25%-30% of the hogs sold on the open market, so we actually have a stake in keeping hog prices up.

American consumers and our customers abroad have demanded leaner pork. Smithfield and other companies have given it to them. We have developed our *Lean Generation* line of pork because of that demand from the marketplace. This pork product offers dramatically reduced fat content. It has been certified by the American Heart Association as "heart healthy." It also has boosted demand for pork. We all agree that those are good things for Americans' health and for everyone who raises hogs. We are able consistently to provide this new leaner pork because we have been able to control carefully the way that hogs are raised. Without some level of coordination among hog producers and meat packers, we will be out of the business of producing the consistently lean pork that has proved so popular both here and abroad.

Traceability, Food Safety and Security

There are other benefits to a coordinated system of production that allows us to trace the origin of any pork product. Special animal identification techniques are introduced at the

farm and stay with the animal until final processing. Even at the early stages of a hog's life, our on-farm biosecurity procedures, and the data they produce, are completely within our control under the Smithfield system. Again, it is a reasonable level of vertical coordination that allows us to ensure delivery of safe meat products, as well as to comply with EPA standards and other regulations.

If we break up that chain of control in an artificial way, it will become more difficult to prevent contamination and to trace it to its source. Contamination is a serious risk. As you make decisions about the structure of our industry, please remember that rules about the economics of our industry can have consequences that reach far beyond economics. We at Smithfield and others in our industry have always had a responsibility to protect American consumers and ensure food safety. We have done that by ensuring that the product is fresh, that the process is hygienic and our facilities clean. But there is another threat that has been made more real to us since September 11, 2001. We must guard against the possibility that our products will become the weapons of terrorists who could seek to taint the food supply and kill or harm a great number of people, while crippling our industry as well as the restaurant and retail grocery industry. The current level of coordination in our system enables us to keep our products traceable and limits the number of people who have access to the products all along the chain of supply from the farm to the kitchen table. I want to ask you very seriously to consider this reality when you make decisions about the structure of our industry. It is not just a matter of economics; it is also a matter of food safety, of homeland security. We have always been happy to bear the responsibility to ensure the safety of the people who buy our products; in recent times that responsibility weighs a bit more heavily.

Managing Economic Risk

Just as our business model relates to security, it relates to risk management. It greatly reduces economic risk for producers, packers and ultimately the consumer. Forward contracting allows farmers to plan for the future. Farmers who choose contracts or marketing agreements with Smithfield or other companies also may find that their credit options are much more varied and attractive.

Bankers and other lenders now routinely demand that farmers produce contracts before providing them with financing to operate their farms. In our system both company-owned farms and contract growers have the benefit of a predictable place to sell their animals regardless of any spikes or downturns in current market prices. Those farmers operating outside an integrated system cannot so reliably predict their future. They face a high level of economic risk that is bound to bring disaster during aberrant periods in the market. Those who operate within a coordinated structure are protected from that unpredictability, and are better equipped to weather the challenges of a global market. There are many contract farmers who believe that they could not survive as a hog farmer without the stability provided under contracts with companies like Smithfield.

Family Farms

Of course, not everyone will choose the contracting route - people will decide whether to take advantage of that opportunity on the basis of their own practical judgments and values, as they should always be free to do. We understand that those decisions are made in the context of family tradition, by American farmers who value their independence and take so much pride in the land and in the work of feeding the world. They have had to make tough choices and to adapt to a changing marketplace as has every business that means to succeed in the global economy. Some of the family farmers this hearing is concerned with are our fellow hog producers, and they are also our suppliers. You may be interested to know, for example, that John Morrell purchased slightly more than half of its hogs (50.8%) from non-contract farmers in the fiscal year ended April 2003, which amounted to almost 4 million hogs. We respect the family farmers and value their work and their right to compete in the marketplace, but we don't agree that barring our company and others from raising hogs will improve the lot of independent hog producers in the marketplace. It plainly *will* harm the independent producers who do contract with Smithfield and other companies as well as the farmers who sell millions of hogs to Smithfield and Farmland on a negotiated basis today

Conclusion

John Morrell and all of the Smithfield Foods companies are part of a highly competitive business. We have built our business model in response to the non-negotiable demands of the consumer and the marketplace. We have met those demands by adapting, with a flexibility that we have achieved through a reasonable level of vertical coordination. That model has allowed us to succeed in business that relies on commodities yet maintain low and stable prices for consumers by owning and contracting for hogs. Our competitors in the poultry industry and in the hog industry in Canada and other countries long ago implemented far greater levels of vertical coordination, often with subsidies and with specific relief from prevailing regulations. We ask for no such relief. We ask only that our company and our industry not be barred from owning or contracting for some of our hogs as we strive to keep our company and our nation's meat industry competitive. We honor the family farm, as we enjoy mutually beneficial relationships with so many family farmers who raise hogs for Smithfield. We ask you to keep in mind that the coordination of our system serves the food security effort against contamination, both accidental and intentional. Finally we ask you to look at the economic data and consider what a ban on packer ownership would do to our industry and others. You are right to try to protect the interests of your constituents; we submit that you can do that best by resisting the call to impose a ban on packer ownership of livestock.

Some may say that Smithfield's proposed acquisition of Farmland assets has the potential to harm small hog farmers, but there is absolutely no basis for this concern. Smithfield believes that the proposed acquisition will save a failing company from bankruptcy, keep Farmland's slaughter plants running without interruption, and maintain small farmers access to existing purchase points for their hogs.

I have attached several documents which I request to be made a part of the record of this hearing.

Thank you very much.

Items for Submission to the Record with
Testimony of- Joseph Sebring
Antitrust Subcommittee of the U.S. Senate Judiciary Committee
July 23, 2003

I. Fact Sheet - Farmland's Agreement to Sell Farmland Foods to Smithfield Foods: In the Best Interests of Independent Hog Producers and Farmland's Employees, Communities, Customers and Creditors

II. List of Farmland Creditors and Bondholders

III. Charts

a. Margin Analysis of Top 1/3 Packers and Producers
b. Hog Slaughter and Hog Price "1980s"
c. Hog Slaughter and Hog Price "1990s"
d. U.S. Hog Breeding Herd: Beginning Inventories
e. Canadian Hog Breeding Herd: Beginning Inventories
f. U.S. Swine Imports from Canada

IV. Potential Impacts of the Proposed Ban on Packer Ownership and Feeding of Livestock: A Special Study

**Farmland's Agreement to Sell Farmland Foods to Smithfield Foods:
In the Best Interests of Independent Hog Producers and Farmland's Employees, Communities, Customers, and Creditors**

Farmland and its Creditors – Including Representatives of its Bondholders, Suppliers and Banks – Chose Smithfield's Offer to Acquire Farmland Foods Over All Other Alternatives Because It Will:

- Provide value to Farmland's bondholders and unsecured creditors, including 20,000 farmers, livestock producers, suppliers and other former co-op members, and 141,000 small businesses across the Midwest and Great Plains;
- Preserve the jobs of Farmland Foods' 6,100 employees;
- Recognize the UFCW at all unionized facilities;
- Ensure all Farmland Foods production facilities continue operating;
- Keep Farmland Foods as a stand-alone business run by its current management;
- Keep the current Farmland Foods headquarters employees based in Kansas City;
- Honor all current Farmland Foods contracts with independent hog producers;
- Continue significant purchases of hogs on the open market; and
- End more than a year of uncertainty suffered by Farmland's 600,000 farmer-members and their communities under the Farmland bankruptcy.

In addition, Smithfield has offered to assume the Farmland Foods pension plan.

A rapid conclusion to the year-long Farmland bankruptcy process is vital:

- Farmland owes $570 million to unsecured creditors.
- Farmland owes approximately $900 million to 141,000 small businesses.
- All of Farmland's major assets now have pending sale agreements.
- The Smithfield purchase of Farmland Foods would move the process forward to allow payments to Farmland's creditors to be made at an early date.

Farmland Foods operates facilities and contracts with hog producers in ten heartland states
The former co-op members and pork assets -- as well as the small businesses and customers they serve – are located mainly in Kansas, Iowa, Illinois, Missouri, Minnesota, Nebraska, Oklahoma, Ohio, Utah and Wisconsin. Farmland Foods has more than 6,000 employees, and in 2002 had revenues of $1.8 billion.

An end in sight: More than a year of suffering under bankruptcy is nearing conclusion
Farmland Industries filed for bankruptcy on May 31, 2002. At the time it comprised 1,700 cooperatives owned by 600,000 farmer-members across the Midwest. Among Farmland's unsecured creditors are 20,000 farmers, livestock producers, suppliers and other former co-op members, as well as 141,000 small businesses. These individuals and small businesses have a collective $1.47 billion in jeopardy with Farmland, and none can recover any money until the bankruptcy case is concluded. The prolonged bankruptcy is causing hardship to them and to their farm communities.

Farmland has agreed to sell all of its assets in order to raise cash to repay its creditors. When all of the sales close, the bankruptcy case can conclude and Farmland can pay its creditors. It is important that there are no delays in the closing of the asset sales.

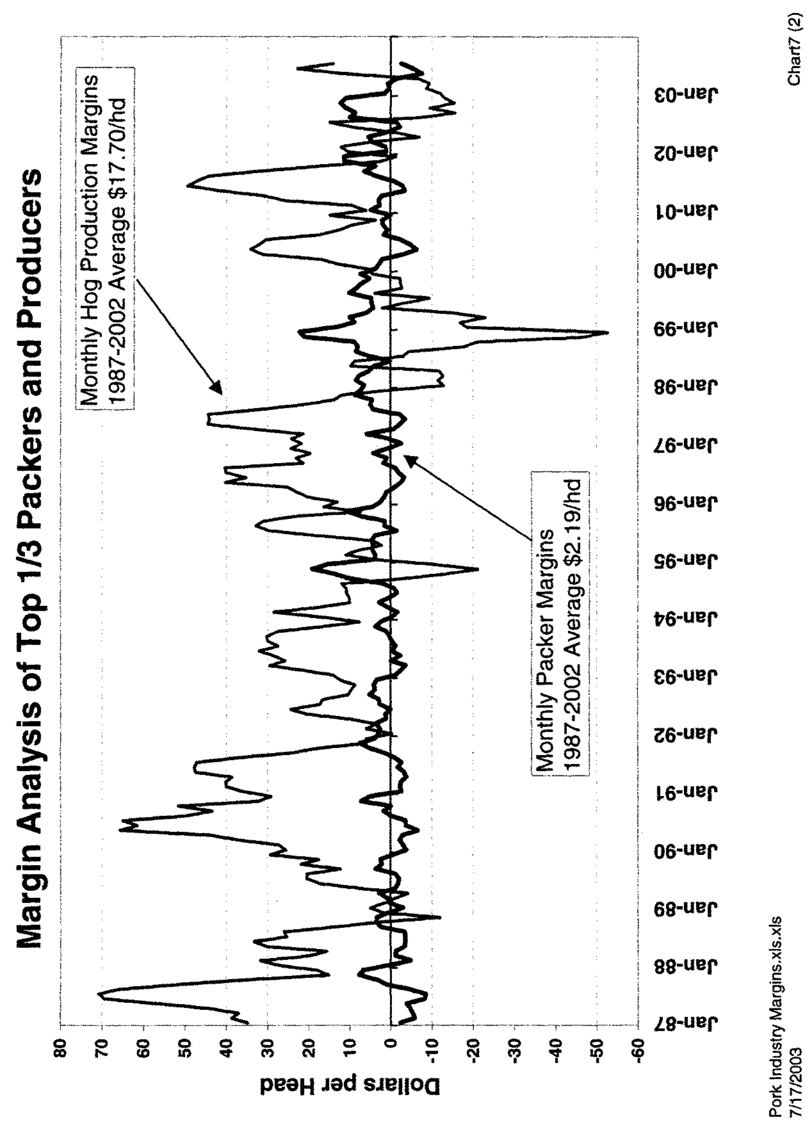
Farmland has selected Smithfield's offer to acquire Farmland Foods over all other alternatives
After a lengthy marketing procedure and solicitation of bids from a number of possible purchasers, Farmland selected Smithfield Foods, Inc. to be the stalking horse bidder in the auction process. Farmland will continue the auction process to determine if a higher bid may be available.

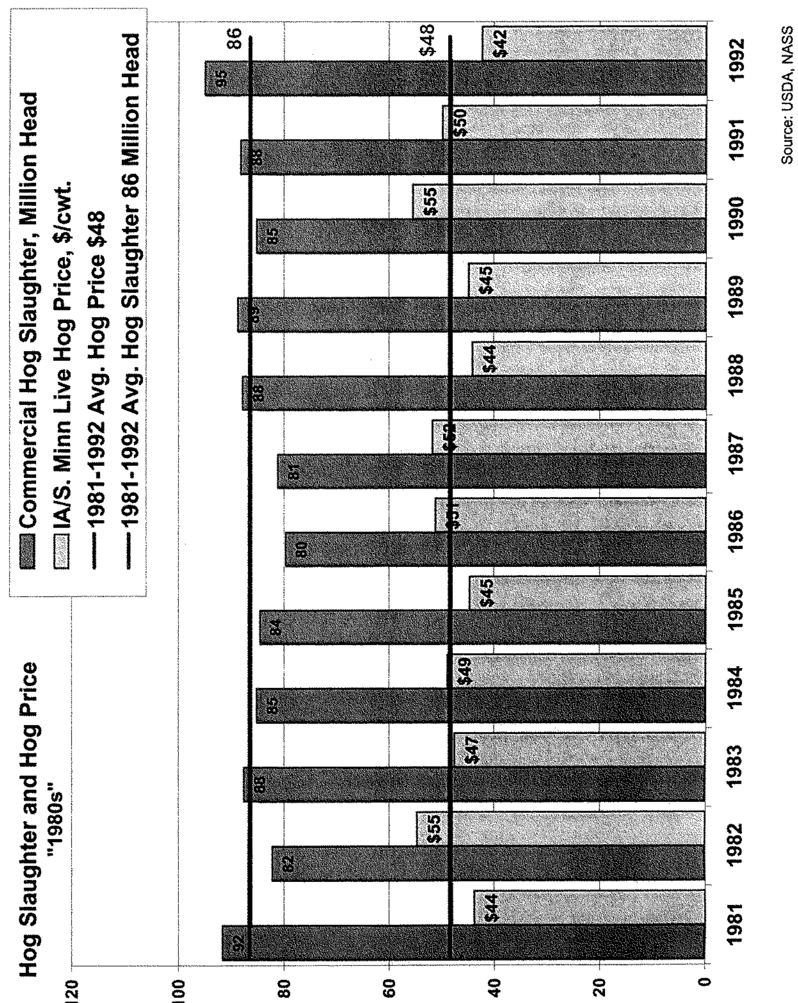
Smithfield: A proven partner to independent farmers and an environmental leader
Smithfield Foods is a good corporate citizen that has enjoyed a long and mutually beneficial relationship with more than 1,700 independent contract farmers. Smithfield understands independent farmers' needs, respects their values and has demonstrated that it can serve them as a strong and valued partner.

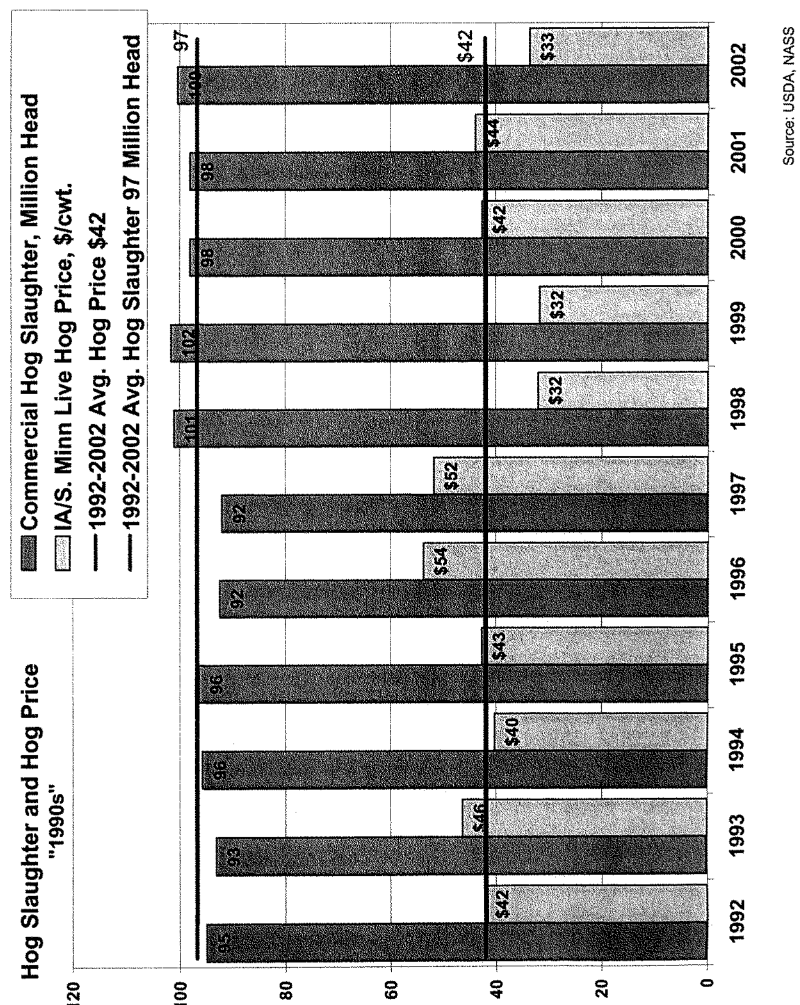
LIST OF FARMLAND CREDITORS AND BONDHOLDERS

STATE	NUMBER OF CREDITORS	$ AMOUNT OWED	NUMBER OF BOND HOLDERS	$ AMOUNT
AK	4	18,018.23	1	960.00
AL	34	603,851.43	15	798,384.05
AR	165	1,196,999.96	117	16,460,445.54
AZ	229	7,914,126.20	9	31,387.59
CA	286	3,532,496.11	5	4,369.17
CO	1512	65,990,358.70	145	27,605,265.96
CT	26	340,881.58	1	1,906.30
DC	51	83,940.59	2	1,579.00
FL	122	2,484,607.96	5	106,287.43
GA	66	484,733.62	13	795,955.07
HI	4	6,730.54		
IA	4202	37,035,223.37	4257	92,305,460.93
ID	44	889,982.75	15	673,878.00
IL	603	11,762,311.99	519	27,931,239.00
IN	65	662,019.61	41	3,402,274.49
KS	5659	160,827,210.20	1257	117,860,428.81
KY	47	302,829.59	8	446,975.36
LA	95	305,627.48	112	4,300,779.24
MA	26	457,107.46		
MD	29	286,246.39	1	917.00
ME	5	1,165.85	1	1,394.00
MI	118	733,309.35	40	1,636,939.00
MN	877	23,006,054.56	288	28,774,361.98
MO	2744	195,820,437.08	166	23,603,119.00
MS	81	4,387,758,52	253	5,533,835.90
MT	26	221,592.95	48	503,975.78
NC	53	967,387.02	2	2,071.49
ND	122	4,351,226.76	184	8,036,131.00
NE	2152	69,114,886.84	1935	96,475,542.20
NJ	41	392,988.27	1	736.00
NM	27	514,781.50	19	1,239,899.93
NY	132	1,342,065.47	5	13,249.51
NV	18	556,588.13		
OH	80	4,772,855.61	21	1,746,045.72
OK	1104	26,065,793.20	170	51,167,791.48
OR	41	635,809.64	9	98,173.75
PA	108	2,166,404.43	3	6,328.74
SC	26	403,431.43	2	24,654.61
SD	2265	84,383,654.17	290	27,955,341.47
TN	57	423,024.47	12	490,695.61
TX	893	48,021,176.61	297	40,826,439.35

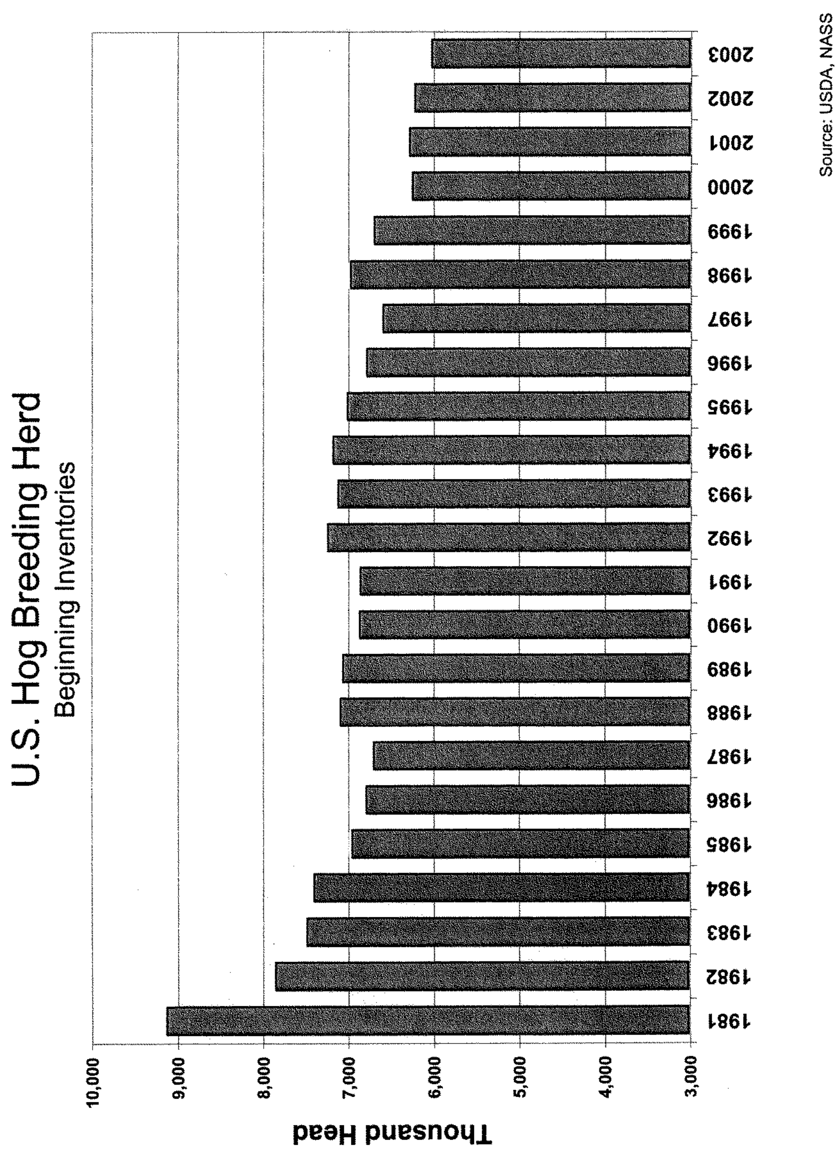
UT	29	809,802.21	11	90,294.12
VA	47	753,134.42	5	258,866.61
WA	66	1,392,923.25	28	231,216.12
WI	47	843,070.35	114	3,932,830.00
WY	168	12,210,467.62	20	1,143,168.00


Margin Analysis of Top 1/3 Packers and Producers
Dollars per Head
80
70
60
50
40
30
20
10
0
-10
-20
-30
-40
-50
-60
Jan-87
Jan-88
Jan-89
Jan-90
Jan-91
Jan-92
Jan-93
Jan-94
Jan-95
Jan-96
Jan-97
Jan-98
Jan-99
Jan-00
Jan-01
Jan-02
Jan-03
Monthly Hog Production Margins
1987-2002 Average $17.70/hd
Monthly Packer Margins
1987-2002 Average $2.19/hd
Pork Industry Margins.xls.xls
7/17/2003
Chart7 (2)


Hog Slaughter and Hog Price
"1980s"
Commercial Hog Slaughter, Million Head
IA/S. Minn Live Hog Price, $/cwt.
1981-1992 Avg. Hog Price $48
1981-1992 Avg. Hog Slaughter 86 Million Head
120
100
80
60
40
20
0
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
92
$44
82
$55
88
$47
85
$49
84
$45
80
81
88
$44
$45
85
$55
88
$50
95
$42
86
$48
Source: USDA, NASS



Hog Slaughter and Hog Price
"1990s"
Commercial Hog Slaughter, Million Head
IA/S. Minn Live Hog Price, $/cwt.
1992-2002 Avg. Hog Price $42
1992-2002 Avg. Hog Slaughter 97 Million Head
120
100
80
60
40
20
0
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
95
$42
93
$46
96
$40
96
$43
92
$54
92
$52
101
$32
102
$32
98
$42
98
$44
100
$33
97
$42
Source: USDA, NASS


U.S. Hog Breeding Herd
Beginning Inventories
Thousand Head
10,000
9,000
8,000
7,000
6,000
5,000
4,000
3,000
1981
1982
1983
1984
1985
1986
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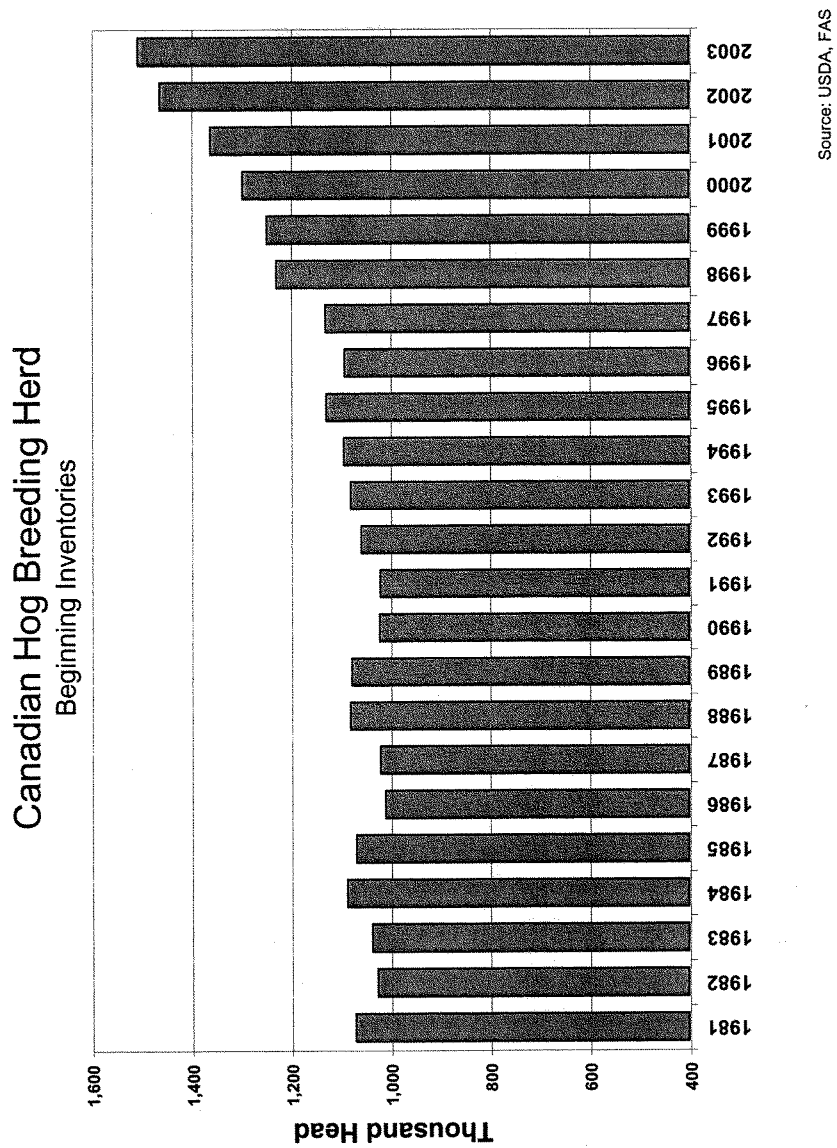
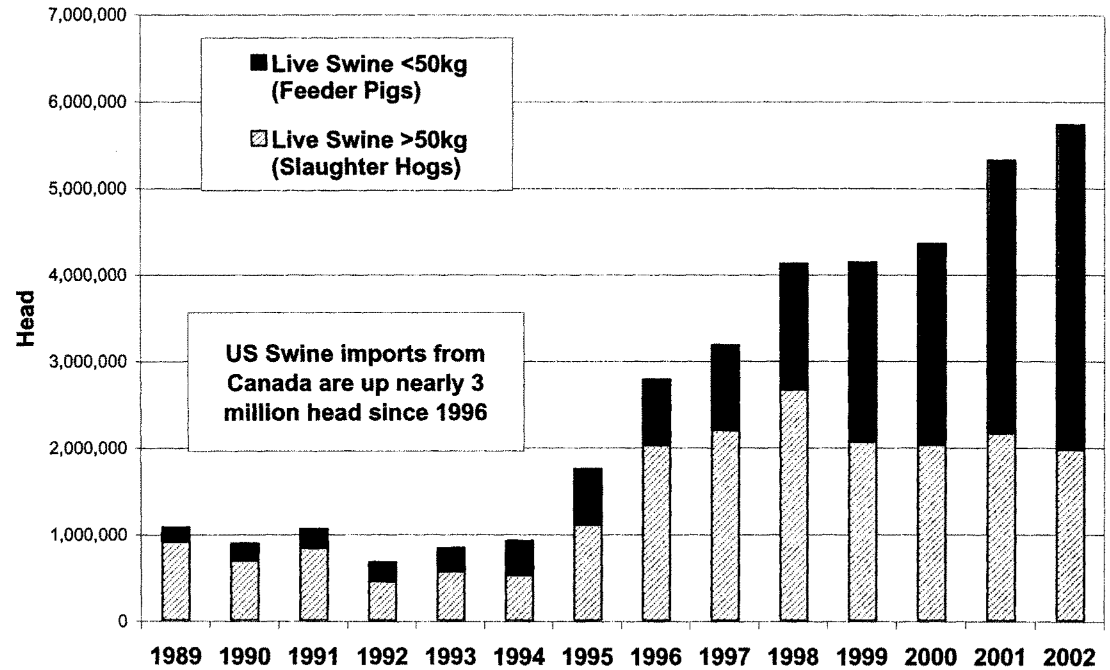
2000
2001
2002
2003
Source: USDA, NASS


Canadian Hog Breeding Herd
Beginning Inventories
Thousand Head
1,600
1,400
1,200
1,000
800
600
400
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
Source: USDA, FAS

US Swine Imports from Canada



Source: USDA, FAS

SPARKS COMPANIES INC.

Potential Impacts of the Proposed Ban on Packer Ownership and Feeding of Livestock

A Special Study

March 18, 2002

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Potential Impacts of the Proposed Ban on Packer Ownership and Feeding of Livestock

Foreword

Last December, Senator Johnson (D-SD) proposed an amendment (the "Johnson Amendment") to the farm bill that would amend the Packers and Stockyards Act (PSA). Subsequently, Senators Grassley (R-IA) and Harkin (D-IA) offered a second-degree amendment to further define the wording of the initial amendment. At this time, the revised amendment is included in S. 1731, passed February 13, 2002. The House farm bill contains no such amendment.

The amendment would make it unlawful for meatpackers to own, feed or control livestock for more than 14 days prior to slaughter. Cooperatives, or entities owned by them, would be exempt if a majority of the ownership interest in the cooperative is held by active cooperative members who own, feed or control livestock and provide them to the cooperative for slaughter. The amendment also would exempt packers who slaughter less than two percent of annual slaughter of each type of livestock.

Study Methodology

This is a study of the potential impacts of the Johnson Amendment. It examines how the various segments of the pork and cattle industries would be affected by a ban on packer ownership, and the short and long-term impacts. The study is based on extensive review of economic statistics, studies and reports and interviews across the major industry sectors by experts with first-hand knowledge of the beef and pork industries.

The study was commissioned by the National Cattlemen's Beef Association (NCBA) and the National Pork Producers Council (NPPC) to be an objective evaluation of both the source of the current structural change in the red meat industry, and likely impacts of the Amendment.

Sparks Companies, Inc.

Sparks Companies, Inc., is the world leader in broad-based agricultural and commodity market research, analysis and consulting. Founded in 1977, the company now serves more than 750 firms and institutions worldwide from our headquarters in Memphis, Tennessee, our Washington, D.C. office and a far-reaching network of offices overseas.

Potential Impacts of the Proposed Ban on Packer Ownership and Feeding of Livestock

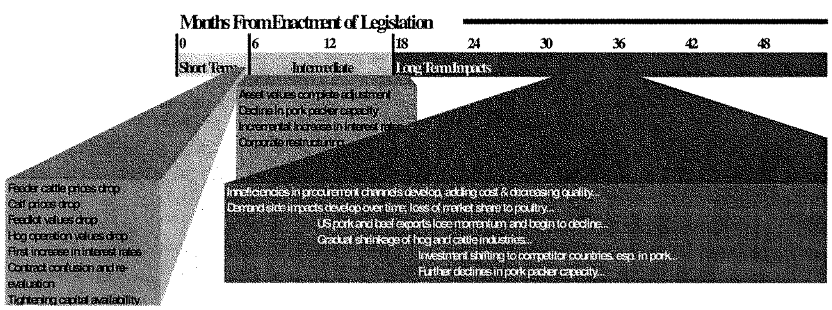
Executive Summary

Study Findings

The Johnson Amendment likely would result in immediate and long-term negative impacts for all sectors of the US pork and beef industries, from independent producers to packers. No segment can expect to benefit, and each would likely face significant losses.

- The Amendment assumes that packers use livestock ownership and marketing arrangements to exert market power at the expense of independent producers, and would outlaw many common management tools, primarily packer ownership of livestock.
- This intervention would strike at the heart of recent industry advances, reducing efficiency and raising costs at all levels of production and processing. And, it could undercut recent increases in consumer demand and export sales.
- The costs of such interventions would be felt immediately, and some costs would continue indefinitely (See Diagram).

Time Line of Packer Feeding and Ownership Ban Impacts



The contrast between states with growing herds and those where swine herd numbers declined is stark. All of the principal declining states were characterized by restricted packer ownership, with no packer ownership allowed in eight of the ten. In nine of the ten rapid-growth states, there was a significant component of packer ownership of hogs while in the remaining state a strong contracting linkage was permitted between producers and packers.

Potential Impacts of the Proposed Ban on Packer Ownership and Feeding of Livestock 3

10-Year Trend in US Swine Breeding Herd and Relationship to Packer Ownership of Hogs

Top 10 Breeding Herd Growth States ('000 head Dec 1)

Rank	State	1992	2001	Increase %	Increase head	Packer Ownership
1	UT	6	70	1067%	64	YES
2	OK	35	340	871%	305	YES
3	WY	5	21	320%	16	YES
4	CO	55	175	218%	120	YES
5	NC	500	1000	100%	500	YES
6	TX	70	100	43%	30	YES
7	PA	105	130	24%	25	YES
8	MS	25	28	12%	3	NO
9	KS	160	170	6%	10	YES
10	MO	375	380	1%	5	YES
	Total/Avg.	1336	2414	81%	1078	

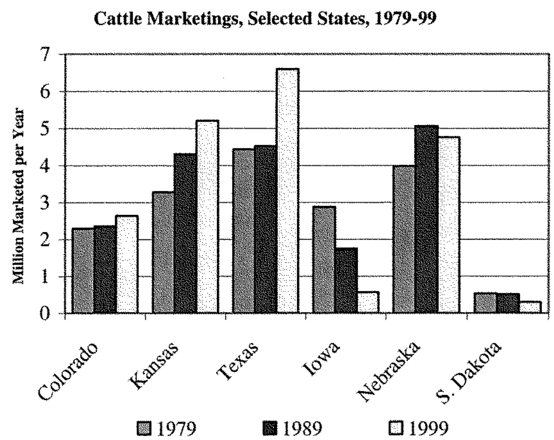
Top 10 Breeding Herd Decline States ('000 head Dec 1)

Rank	State	1992	2001	Decline %	Decline head	Packer Ownership
1	GA	155	50	-68%	-105	NO
2	TN	85	30	-65%	-55	NO
3	WI	170	65	-62%	-105	NO
4	KY	120	50	-58%	-70	NO
5	SD	235	145	-38%	-90	NO
6	IN	550	340	-38%	-210	NO
7	MI	175	110	-37%	-65	NO
8	NE	580	370	-36%	-210	NO
9	IL	700	450	-36%	-250	SMALL
10	IA	1700	1130	-34%	-570	SMALL
	Total/Avg.	4470	2740	-39%	-1730	

	US	**7109**	**6209**	**-13%**	**-900**	**23%**

Similarly, in states that have constrained investment in cattle feeding marketings have declined, while others have attracted substantial new investment (See Chart).

<u>Potential Impacts of the Proposed Ban on Packer Ownership and Feeding of Livestock 4</u>



Amendment Costs

The study examined potential impacts of Amendment costs at all levels of the industry, and estimated cost impacts at each level. Cost impacts would differ widely, both in their timing and in their impacts. Impacts are measured at the producer level for both cattle and hogs.

- **Initial divestiture impacts would be severe but temporary, and would affect packer-owners and other livestock owners, as well.**
  - For hogs, the midpoint estimate of this one-time cost is $1.2 billion, but could reach $1.8 billion or be as low as $0.6 billion depending on market conditions.
  - For feeder cattle and calves, the midpoint of this estimate is $2.4 billion, but could reach $2.5 billion or be as low as $2.3 billion.

- **Increased capital costs across the industry as lenders increase their risk premium.**
  - For hogs, the midpoint estimate of this impact is $83.5 billion, but could be as high as $133 million or as low as $34 million.
  - For cattle, the midpoint estimate is $314 million, but could be as high as $523 million or as low as $105 million.

- **Reductions of packers' operating efficiency and increased risk.**
  - For hogs, the midpoint of the estimate of this impact is $1.4 billion, but could be as high as $2.16 billion or as low as $0.55 billion.
  - For cattle, the midpoint of this estimate is $90 million, but could reach $130 million or be as low as $51 million.

- **Reduced domestic demand for meats.**
  - For hogs, the midpoint of this estimate is $357 million, but could be as high as $595 million or as low as $119 million.
  - For cattle, the midpoint of this estimate is $213 million, but could be as high as $267 million or as low as $160 million.

- **Reduced export demand for meats.**
  - For hogs, the midpoint of this estimate is $469 million, but could be as high as $750 million or as low as $188 million.
  - For cattle, the midpoint of this estimate is $53 million but could be as high as $66 million, or as low as $40 million.

- **Transfer and relocation of significant amounts of pork production and ownership to Canada and Mexico.** The midpoint of this estimate is $1.1 billion, but could be as high as $2 billion or as low as $0.1 billion.

Impacts expected across the sector likely would be large, would begin immediately and could severely damage the sector's competitive position in US and overseas markets. Midpoint estimates of losses for hogs across categories, and including both temporary and continuing costs are $4.5 billion, but could reach $7.4 billion or be as low as $1.6 billion. The midpoint estimate of losses for cattle across categories could be somewhat smaller, $3.1 billion but could be as high as $3.5 billion or as low as $2.7 billion.

Impacts on States

Impacts of the Amendment would vary widely by states, depending on the size of the production and packing industries located in each. (See tables). The estimates represent losses for hog producers, and are allocated on the basis of each state's breeding herd. The allocation does not reflect situations where some adjustment to packer feeding restrictions has already occurred, but is indicative of relative impacts of the Amendment.

The losses include both loses from temporary, one-time events and those evolving from declines in competitiveness and efficiency. The estimates represent the midpoint of the ranges estimated for each state. For example, for Iowa, the mid-point estimates of all types of losses would amount to $0.8 billion, could be significantly lower or as high as $1.3 billion.

Potential Impacts of the Proposed Ban on Packer Ownership and Feeding of Livestock 6

Impacts of Johnson Amendment of Hog Producers by Type of Loss, by State

State:	Capacity	Credit	Equity	Efficiency	Risk	Demand	Exports	Relocation
				million $				
IA	181	15	216	15	48	64	84	189
NC	161	13	192	14	42	57	75	168
MN	91	8	108	8	24	32	42	95
IL	70	6	84	6	19	25	33	74
NE	60	5	72	5	16	21	28	63
MO	60	5	72	5	16	21	28	63
IN	50	4	60	4	13	18	23	53
CO	30	3	36	3	8	11	14	32
KS	30	3	36	3	8	11	14	32

Impacts are midpoint of range estimates, allocated by Dec 1, 2001 breeding herd share.

The losses for cattle also include both losses from temporary, one-time events as well as those evolving from declines in competitiveness and efficiency. The estimates represent the midpoint of the ranges estimated for each state. For example, for Texas, the mid-point estimates of all types of losses would amount to $0.5 billion, and could be significantly lower or as high as $0.6 billion. The estimates do not reflect situations where some adjustment to packer feeding restrictions have already occurred, but are indicative of relative impacts of the Amendment.

Impacts of losses for Cattle Producers by Type of Loss, by State

State	Demand for Feeder Animals	Cost of Credit	Loss of Feedlot Asset Value	Plant Efficiency Loss	Risk Cost	Loss of Domestic Demand	Loss of Export Demand
	----- Estimated Impact By State (in Million $) -----						
TX	244.1	59.2	167.8	9.2	7.8	40.2	10.0
KS	71.2	38.0	144.0	5.9	5.0	25.8	6.4
NE	88.1	36.6	130.3	5.7	4.8	24.9	6.2
CO	39.0	22.8	87.8	3.6	3.0	15.5	3.8
OK	91.5	14.9	29.5	2.3	2.0	10.1	2.5
SD	96.6	11.8	13.0	1.8	1.6	8.0	2.0
CA	66.1	10.7	20.9	1.7	1.4	7.3	1.8
IA	50.9	10.0	24.5	1.6	1.3	6.8	1.7
MO	98.3	9.1	0.0	1.4	1.2	6.2	1.5
ID	33.9	8.6	25.2	1.3	1.1	5.9	1.5
MT	76.3	7.1	0.0	1.1	0.9	4.8	1.2
WA	17.0	6.4	22.3	1.0	0.9	4.4	1.1
KY	50.9	4.7	0.0	0.7	0.6	3.2	0.8
AZ	10.7	4.4	15.8	0.7	0.6	3.0	0.7
NM	25.4	3.8	6.5	0.6	0.5	2.6	0.6

Potential Impacts of the Proposed Ban on Packer Ownership and Feeding of Livestock 7

Impacts by Species

The estimated range of impacts on the hog production sector varies widely, across the range of impact sources (See table). The loss of equity for farrow-to-finish operations reflects value of both facilities and hogs, on a per-sow basis.

Potential Impacts of Amendment per Head of Hogs

One time Impact on Hog Production Sector 1/	**Low**	**Midrange**	**High**
		$ per sow	
Loss of Farrow-Finish Equity Value	100.00	200.00	300.00
Recurring Impacts on Hog Production Sector 2/		*$ per barrow or gilt*	
Reduction in US Packing Plant Capacity	3.36	10.64	17.91
Cost of Credit	0.36	0.89	1.41
Plant Efficiency Loss	0.36	0.91	1.45
Risk Cost	2.10	2.80	3.50
Damage to Domestic Pork Demand	1.26	3.78	6.29
Damage to Pork Export Demand	1.99	4.96	7.93
Relocation of Investment	1.06	11.10	21.14

1/ A one time impact allocated across 6 million breeding inventory.

2/ Ongoing Impacts allocated across annual barrow and gilt slaughter.

Individual impacts may not be additive because of interactions.

The estimated range of impacts per head across the cattle sector varies widely, across the range of impact sources (See table). The loss of equity for feedlot asset values reflects value of both facilities and hogs, on a per-head basis.

Potential Impacts of Amendment per Head of Cattle

Cattle Feeding Segment ($/hd fed in one year) 1/	**Low**	**Midrange**	**High**
Loss of Feedlot Asset Value	$ 21.05	$ 25.26	$ 29.47
Calf Production Segment ($/hd. destined for feedyard) 2/			
Demand Impact on Feeder Animals 3/	$ 44.37	$ 44.37	$ 44.37
Cost of Credit	$ 2.74	$ 8.22	$ 13.69
Plant Efficiency Loss	$ 0.52	$ 1.28	$ 2.04
Risk Cost	$ 0.81	$ 1.09	$ 1.36
Damage to Domestic Beef Demand	$ 4.18	$ 5.59	$ 6.99
Damage to Export Beef Demand	$ 1.05	$ 1.39	$ 1.73

1/ A one-time impact spread across 28.5 million head.

2/ In the long-run all of these items flow back to the bottom of the marketing chain and that is what is reflected here.

Short-term, the feeding sector may bear some of these costs.

These figures are estimates only and are not considered to be additive.

3/ Transitory loss, not expected to persist more than a year or two.

Potential Impacts of the Proposed Ban on Packer Ownership and Feeding of Livestock 8

Under the Johnson Amendment

- US production efficiencies decrease, resulting in declines in the industry, increasing opportunities for competing products and competing international producers who could become more efficient and better marketers than US producers. Weaker domestic and export demand could accelerate these declines.

- The US poultry industry, which has grown more than 600% since 1960 could face less competition for US markets.

- Declining margins for both packers and feeders could stimulate consolidation as higher-cost operations, most often the smallest, are forced to close.

- Investment in superior products and retail brands would be constrained and the capacity of processors to satisfy demands of rapidly consolidating retailers for greater uniformity and higher quality would decline, both in the United States and overseas.

- Very substantial immediate losses for livestock producers and narrower margins for the meatpacking industry would reduce tax revenues and increase federal and state budget pressures.

Focus of the Debate

Proponents of the Amendment appear to misunderstand the nature of the competitive forces driving change across the red meat and poultry industries today. The study concludes that primary competitive pressures among products are at the consumer level, driven by basic changes in society and domestic and international demands for quality, convenience, and services as lifestyles evolve (See Charts). The vast bulk of the change in prices and values at farm, wholesale and retail levels reflect costs of services while the farm-wholesale spread has been stable or declining for most of the past two decades as efficiency has grown. New costs packers are required to pay in recent years include:

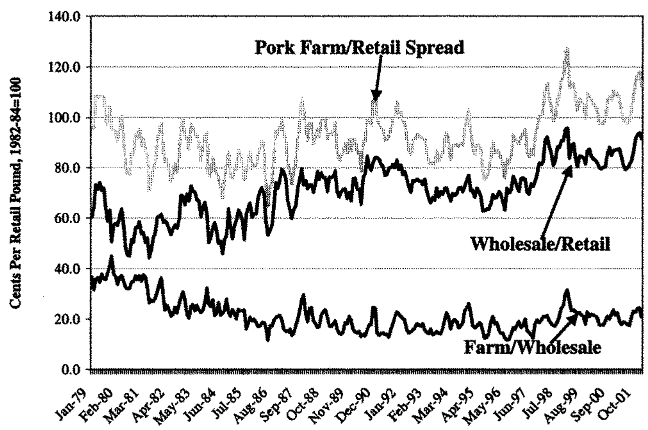
- Inspection fees and new steam vacuum procedures for carcasses, along with an acid bath that also adds to costs;
- Trimming costs, with most beef now sold as closer trim (1/4 inch or less) compared to commodity trim (3/4 inch or more), thus increasing costs. And, more product now is boneless, especially beef;
- New, more expensive safety rules such as HACCP, waste water treatment and others;
- Higher labor costs in response to much tighter supplies of labor.

In spite of higher costs, the farm to wholesale spreads shown below are generally lower than they were in the 1980s in inflation-adjusted terms, and reflect steady increases in efficiency across the sector. Nevertheless, the legislation proposes to regulate the farm

and processor levels while the major widening of the spreads has been at the wholesale-retail levels.

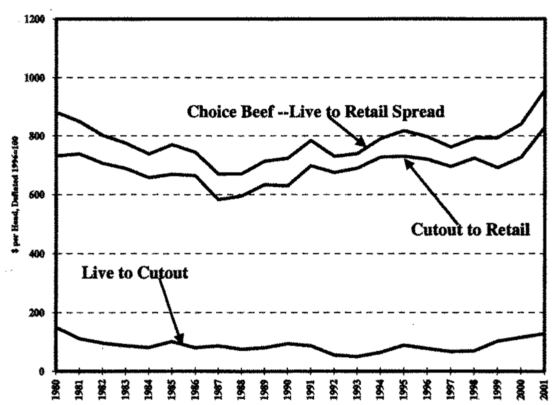
Potential Impacts of the Proposed Ban on Packer Ownership and Feeding of Livestock 10

Pork Price Spreads, 1979-2001



Source: ERS, USDA

Beef Price Spreads, 1980-2001



The poultry industry pioneered the strategy of providing additional services to compete with other meats as an avenue to market growth in the 1950s, and the red meat sectors followed that success more recently. A significant negative impact of the Amendment is that it would constrain beef and pork industry efforts to provide the consumer-friendly products to compete with poultry at the consumer level.

<u>**Potential Impacts of the Proposed Ban on Packer Ownership and Feeding of Livestock 11**</u>

The proposed Amendment would intervene at the processing and livestock production levels where product competition is mainly reflected, not where it originates. It would impose unwarranted costs where they would benefit no one, without strengthening demand, efficiency, technology, or competition. Over the longer-term, the Amendment would be unlikely to benefit any sector in the domestic beef or pork industries, and especially not livestock producers who expect wider margins and greater independence to result from this proposed legislation. The end results likely would be lower producer prices, higher costs, smaller markets and diminished returns for the foreseeable future. The study evaluates both the source of the current structural changes in the red meats industry, and the likely impacts of the Amendment.

Transition

Proponents of the Amendment argue that the transition periods it includes would permit an orderly transfer of ownership of packer-owned livestock and facilities. The study concludes, based on extensive interviews across the industry that such a transition is quite unlikely. Instead, the proposal would have major short-term and longer-term impacts, including:

- **Divestiture of packer-owned livestock, and packer owned livestock feeding facilities.** While this would take place over transition periods for beef and pork, the impacts would be severe, immediate and persistent. They would reduce the value of livestock, livestock feeding facilities, and breeding facilities throughout the United States. By restricting packers' application of a number of strategic management tools, the Amendment would be expected to increase operating costs, reduce output and reduce returns to both packers and livestock producers.

- **Curtailment of new marketing contracts by packers.** Given the intensive factual inquiries required to assess "material participation" as required by the amendment make it impossible for packers to confidently assess the legal risks presented by existing arrangements under the Amendment. It is likely that packers who have committed to purchase livestock under long-term marketing agreements would refrain from offering new contracts to producers until the legislation is clarified or enforcement of the legislation is made clear by the USDA.

  Surveys by Iowa State University indicated that 22,748 hog producers sold more than 1,000 hogs in 2000. About one-half of the smaller producers (<5,000 hogs sold) used marketing contracts. Thus, it is clear that substantial restrictions on such contracts would have negative impacts on many smaller operations.

- **Curtailment of financing by lenders.** For similar reasons, it also is likely that lenders, which finance livestock producers, would desire time and clarification of the legislation before advancing new funds for the expansion of facilities or herds. Frequently, such expansions are based, at least in part, on the terms of long-term marketing agreements by which producers secure a buyer for their production, obtain

premium prices and limit market risk. Should such arrangements become legally suspect, it is only logical to expect that lenders would not be willing to absorb this additional risk.

- **Revision of existing marketing contracts**. Should packers determine that the legislation impairs their ability to enter into long-term marketing arrangements, we would anticipate they will attempt to identify other tools to achieve the goals, which such contracts have provided them. This may require packers to attempt to renegotiate existing contracts inasmuch as the legislation does not exempt existing contracts from its scope.

- **Corporate restructurings**. Packers could also attempt to meet the terms of the Amendment via various restructurings or liquidations of selected assets. At least one packer has publicly suggested that it would cease operations at one of its plants should the Amendment be enacted. The Amendment would appear to require packers who own livestock to divest themselves of such livestock. The manner of such divestitures would likely be carefully considered by all affected packers, and likely would diminish interest in investment in the industry.

- **Litigation**. Should the Amendment be enacted, there likely would be litigation relating to this legislation brought by packers and/or producers. Challenges to the required divestiture of livestock by those packers that currently own livestock and the exemption for poultry contained in the Amendment also could be brought and would serve to reduce willingness to invest in the industry.

Intermediate Term Impacts

- The intermediate impacts of the Amendment likely would be extensive and entirely negative. They would likely include:

- **A higher-cost, less efficient meat packing industry** in the future with smaller capacity to produce and process cattle and hogs. Costs would be increased by increased costs of capital, reduced plant utilization, higher price volatility and risk and reduced revenues from livestock production. The higher costs would reduce margins and lead to reduced bids for livestock. at the farm level. Lower returns at each level would reduce state and federal tax returns for the sector.

- **Reduced packer-processor investment** at both ends of the value chain, in genetics and livestock management and in branded products and market development. This likely would reduce competitiveness of red meat products in competition for US consumers' dollar, and in export markets. It likely also would mean a reversal of current growing market shares in both markets.

- **Higher-cost, less efficient feeding and breeding industries** in response to higher capital costs for livestock feeders and breeders, reducing margins for both types of investment.

- **A smaller meat packing industry** as lower margins cause less-efficient packers to cease operations and reduce industry capacity. The higher costs would make US packers less efficient in competing with poultry at the consumer level and less efficient in competing with the Danes, Canadians and Brazilians for foreign markets.

- **Smaller breeding and feeding industries** as higher capital costs and weaker returns lead to reduced investment in livestock feeding and breeding, and reduce industry production capacity. The smaller industry would be more dependent on both imported livestock for slaughter and imported meats and meat products.

- **Increased vulnerability for producers in isolated production areas** as packers access to tools to manage supply flows and plant utilization are constrained.

- **Continuing advantage for poultry in the competition** for domestic and international consumers' dollars as investment in quality by the red meat sectors decline. The poultry industry would be in a position to continue to invest in quality and market development efforts while investment and development by red meat producers/processors would decline.

WRITTEN TESTIMONY OF
THE ORGANIZATION FOR COMPETITIVE MARKETS
presented to the
UNITED STATES SENATE
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS
July 23, 2003

Agricultural Consolidation and the Smithfield-Farmland Deal

Thank you Chairman DeWine and members of the Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights for allowing the Organization for Competitive Markets to submit this testimony for the record. OCM is a multidisciplinary nonprofit organization that focuses exclusively on antitrust and competition problems and solutions in agriculture. Our members consist of farmers, ranchers, academics, policy makers and agricultural businessmen.

Horizontal concentration and vertical integration in the food and agriculture sector has harmed food producers and consumers, while the gross margins for retailers and processors increase each year. Farm gate prices for meat have trended lower during the last 20 years as consolidation increases. This is due to oligopsony market power on the buy side of the processors.

Yet consumers do not benefit - rather they continue paying more for pork. Consumers do not benefit from low live hog prices, nor do they benefit from the so-called efficiencies claimed by the packers. The claimed efficiencies of the packer and the retailers have either been false and/or overwhelmed by the market power increase, or both. In fact, during the historic live hog price crash of December, 1998, when prices dropped to eight cents per pound, packer and retailer price gouging resulted in record profits and higher pork prices for consumers. The graphs set forth below illustrate these trends.

Figure 1: Farm-to-Wholesale Price Spread for Pork: USDA data adjusted for inflation

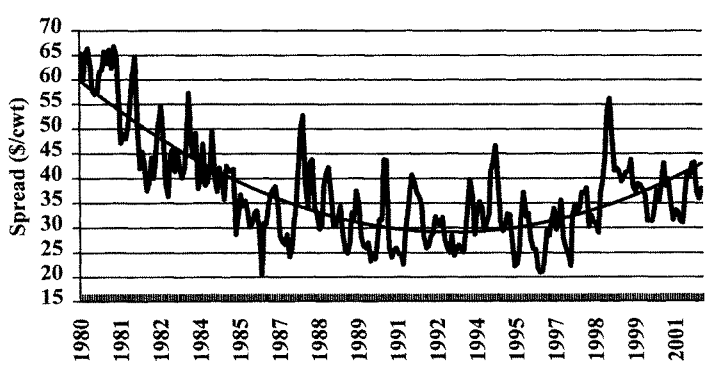
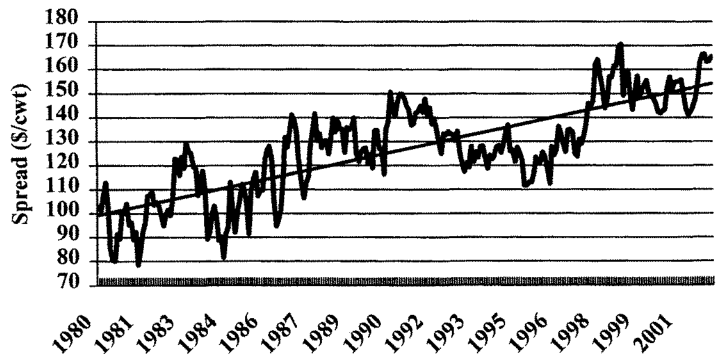


Figure 2: Wholesale-to-Retail Price Spread for Pork: USDA data adjusted for inflation



In a competitive market, the gross profit margins would remain relatively constant because competition does not allow companies to price their sales, or buy their inputs, at levels that exceed normal levels of return. Gross profit margins will increase in a competitive market if a regulatory cost is imposed or if inefficiency pervades the industry so that normal levels of return can be achieved only with a price increase.

Figure 1 shows that the gross profit margin for packers, in the form of price spreads between the farm gate and wholesale, have increased by over one-third in the last 10 years. Figure 2 shows the gross profit margin for consumers, in the form of price spreads between the whole and retail levels. Retailer gross margins for pork have trended steeply upward for 20 years.

There are only two possible explanations for this trend. First, the packers and retailers are increasingly inefficient despite the fact that wage rates have fallen during the past 20 years. Or second, the packers and retailers are increasingly exerting market power to increase their margins far beyond competitive levels at the expense of producers and consumers. OCM has concluded that packers and retailers are exercising undue market power to the detriment of producers and consumers. Efficient resource allocation in the food system has, thus, suffered greatly.

Consider these numbers. The Smithfield acquisition will take out a major competitor, Farmland Foods. This will not cause upward price pressure for live hogs, but downward pressure. Assuming a one dollar per hundred live weight loss in market price, hog farmers will lose $2.70 per hog on 375,000 270 pound hogs per day, or over one million dollars per day. This is over $250 million per year loss for producers, and gain for packers, over one year (assuming 250 packer slaughter days). A two dollar per hundred weight loss is one-half billion dollars per year lost to Rural America's farms and main streets.

The price spread trends explain why both consumer groups and producer organizations oppose the Smithfield acquisition of Farmland Industries' pork division. If Smithfield is allowed to

acquire Farmland Foods pork division, there is no reasonable argument that consumers or producers will benefit. The creditors committee in the bankruptcy court in which Farmland Industries has filed is compelling this sale to Smithfield to maximize debt payoff to the creditors. However, the public interest is in prevention of the acquisition so that Farmland may re-organize, in this Chapter 11 bankruptcy, around its profitable pork division.

PORK PROCESSING INDUSTRY STRUCTURE AND CONDUCT

Horizontal structure: The top tier of pork processors include Smithfield Foods (86,300 daily plant capacity), Tyson/IBP (72,200), Swift & Company (43,000), Cargill/Excel (32,000), Hormel Food Corp. (27,700), and Farmland Foods (25,500). Smithfield's plants include three in the East/Southeast U.S. and two plants purchased from John Morrell & Co. in Sioux Falls, South Dakota and Sioux City, Iowa. Farmland's plants are in Crete, Nebraska; Denison, Iowa; and Monmouth, Illinois. Smithfield is number one in pork slaughter capacity and Farmland is number six. All the top six are active in the Iowa-Southern Minnesota market, which as we will see below, sets the national price for live hogs each day. The second tier competitors, which are not named here, are not relevant to setting national or regional hog prices because they are either too small, or because they are entirely vertically integrated and are not active in the open market.

Vertical structure: The hog industry is approximately 87% vertical at the producer/packer interface[1]. Vertical integration takes the form of packer owned hogs, and various types of contracted hogs. Ninety percent of the hog contracts pay the producer through a formula price based upon the open market price reported each day by USDA's Market News Service. All the pork packers have been aggressively going vertical and have stated as much.

In theory, the 13% of the non-vertical hogs set the price for the open market price reports. In practice, three to five percent of the hogs traded set the price. These are the hogs actually negotiated between packers and producers in the Iowa-Southern Minnesota market, the price setting market. The other non-vertical hogs either are committed to a packer through an oral formula arrangement, or are merely forced to take the "Posted Price" that the packer says it will pay based upon the Iowa-Southern Minnesota market.

Price relationship studies by economists consulting with OCM show that the Iowa-Southern Minnesota market is established each day first, and all other markets follow. Thus, it is the price setting market. It is the driving force for the broader geographic market reported as the Western Cornbelt market, by USDA, from which many contract hogs are priced. The Western Cornbelt market includes, primarily, Iowa, Minnesota, Nebraska, and South Dakota.

Conduct: Packers always have an incentive to push hog prices down to save money. But when 90% of the contract hogs are pegged to the open market price, the marginal cost of bidding higher for open market hogs is tremendously magnified. For example, if the market is approximately $47 per hundred weight for live hogs, and a packer needs to bid $49 to purchase enough hogs to fill the plant for the day, the extra two dollars only affects those hogs purchased at that price. However, with 90% of the contracts pegged to the open market price, if a packer

[1] The processor/retail interface at the wholesale pork price level is also increasingly vertical with the result being ever thinner open market transactions from which price discovery can occur.

bids an extra two dollars for the final hogs it needs, that price is reported by USDA and automatically makes all the contract hogs – tens of thousands of hogs – more expensive.

Conversely, if the packer can force the market down below competitive pricing levels, they save millions on hog procurement costs for the day's purchases. In today's concentrated packer environment, we have dominant firms interacting in a very thin market. This scenario exponentially increases their ability to drive prices lower as compared to a situation where the dominant firm bought all their hogs from a high-volume open market.

It is no surprise that the past 20 years have seen a steady downward trend in hog prices as packers consolidated horizontally and vertically even while the wholesale meat prices justify far more money for live hogs. If Smithfield is allowed to purchase Farmland Foods, this trend will increase, and not decrease. Producers and consumers will suffer as packers and retailers continue price gouging.

SMITHFIELD'S BID FOR FARMLAND FOODS

The Smithfield bid for Farmland Foods is driven by two factors. First, Smithfield continues to desire more market power through eliminating competitors so as to drive hog prices down. Second, the creditors committee, in Judge Venter's bankruptcy court in Kansas City, wants the most money it can get for all Farmland Industries' assets, including Farmland Foods. These two driving factors are inconsistent with the public interest.

Overlapping buying regions of Smithfield and Farmland pork plants: Smithfield Foods operates plants in Sioux Falls, SD and Sioux City, IA. Farmland operates two plants within the same region, one in Crete, NE and one in Denison, IA. The two companies compete for the same hogs because their procurement areas, or "draw areas", overlap significantly. The draw areas primarily include Iowa, Minnesota, South Dakota and Nebraska. Thus, such a sale would increase the buying power of Smithfield tremendously in the all important Iowa-Southern Minnesota and Western Cornbelt market areas.

Manipulating price in the key price setting region: As stated above, the Iowa-Southern Minnesota market is the national price setting market. It is the driving force within the Western Cornbelt market region – consisting primarily of Iowa, Minnesota, South Dakota and Nebraska – from which a tremendous volume of contract hogs are priced. The open market hogs from which markets are made daily in this region are only three to five percent of the national hog market volume. The biggest pork packers - Smithfield, Tyson, Swift, Excel and Hormel – have a far greater opportunity tremendously to use market power to manipulate price in a thin, low volume open market, than in a high volume market. Allowing Smithfield to reduce competition in the national price setting region will significantly increase Smithfield's – and the remaining packer's – ability to push national prices downward for both open market bid hogs and for contract hogs. But there is no reasonable argument that consumers will benefit.

Market power is most harmful for perishable commodities such as pork. Smithfield's market power grab is a far greater problem in the live hog market, a perishable commodity, than market power in a non-perishable market given the same industry concentration levels. This is

because a seller of hogs has to sell within a narrow time window, otherwise the hogs grow too large, are discounted in price and cost more in production costs. In economic industrial organization terms, hog farmers are unable to exercise countervailing market power through withholding hogs from the market. Rather, hog farmers have to sell – even at "fire sale" prices – because they can't hold withhold supply to force bidders to pay more over time. Whereas a seller of books, for example, does not have to sell within a narrow window because the books do not deteriorate and the book seller can exercise countervailing market power by withholding supplies from the market. Thus, concentration in the packing industry is a far greater concern than the same concentration in, for example, the book publishing and sales industry.

Shackle space crisis: Shackle spaces are another term for the plant capacity in pork packing plants. The plant capacity available for hogs is the actual demand factor in the market – consumer demand is indirectly related to live hog demand. There is a substantial prospect that Smithfield could opt to close on or two of its older Midwest plants after the Farmland acquisition. Smithfield has a history of buying plants, closing them down, and guaranteeing that they are never used to slaughter hogs in the future.

For example, Smithfield bought Dakota Pork in Huron, South Dakota on August 8, 1997. One day later, it closed the plant and laid off 850 employees. It then disassembled the plant to ensure no one would operate it again. Smithfield was reported to have sold the plant to the City of Huron early this year with a proviso that it never be used for pork packing.

Smithfield purchased a Farmland Foods plant in Dubuque, Iowa on March 28, 2000. Smithfield made optimistic promises, on April 11, 2000, to spend $10 million to renovate the plant. On June 8, 2000, Smithfield closed the plant and laid off 1,100 employees. It later stripped the Dubuque plant and it lays dormant today, unable to add to live hog demand and cause upward price pressure.

It is unreasonable to assume that Smithfield will stand by its public promises with regard to this sale when it has broken such promises repeatedly in the past and when it has tremendous financial incentives to break those promises. It is reasonable to believe that Smithfield will shutter one or more of the four plants in the Western Cornbelt market that it will own post-transaction.

Bankruptcy Proceedings are Inconsistent with the Public Interest: Farmland Industries filed for Chapter 11 bankruptcy in May 2002 to reorganize itself into a smaller, profit making entity. Fourteen months later, there has been no reorganization plan filed. Rather, the creditors committee has successfully pushed to have the assets of Farmland Industries sold off as if this were a Chapter 7 liquidation. If Farmland is to reorganize, it should do so around its profitable pork business. Antitrust concerns should eliminate the avenue of selling the pork division.

Farmland Foods President George Richter said, in a July 15, 2003 press release, "This agreement reflects the strong value of Farmland Foods. Our employees have done an excellent job over the past year growing the profitability and value of our pork business. The sales price [offered by Smithfield], which may be increased through the auction process, will bring **significant value for the benefit of our creditors**."

This is a creditor driven transaction. The creditor interest should take a back seat to the interest in maintaining the integrity of the open market for income to Rural America. Additionally, it is unlikely that any will bid higher for the pork division because the Smithfield bid has the support of the management team (who want to keep their jobs) and the all-important creditors committee.

Farmland has sold its beef, fertilizer, and grain business. It maintains a petroleum business – which is highly cyclical in nature – and its pork business, Farmland Foods. Farmland Foods is quite profitable, with increasing profits each of the last seven quarters as compared with the same period one year prior. The pork division, which is a stand alone ongoing business, reported $9 million in 3rd quarter operating profits ($36 million annualized) on July 14, 2003.

But for Smithfield's bid to obtain dominant market share at a high price and to scare off other bidders, Farmland could seek bidders that are not an antitrust concern or reorganize around the pork division as several experts speculated they could do.

CONCLUSION

America's farmers and ranchers do not want to receive their income from the taxpayers through a government farm program. They want to make money from a fair and open market. However, the government is presiding over market deterioration that is eliminating the opportunity to engage in private agriculture. The Super Bowl is a hard core, competitive game enjoyed by millions, but it requires rules of the game and umpires to enforce the rules. Fans and advertisers would soon lose interest if the game was mere anarchy and survival of the fittest in the short term. Similarly, market require rules and enforcement of the rules. Congress should not allow such deterioration, even as it proclaims that it wants development in Rural America. The Smithfield acquisition should be prevented.

Thank you for your interest in this issue.

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Statement regarding the "Agricultural Consolidation and the Smithfield/Farmland Deal" before the U.S. Senate Subcommittee on Antitrust, Competition Policy, and Consumer Rights hearing July 23, 2003 by Luther Tweeten, Professor Emeritus of Agricultural Policy and Trade, Ohio State University, Columbus, 43210

The pending acquisition of Farmland Food, the pork division of Farmland Industries, by Smithfield Foods offers greater benefits than costs. The immediate impact will be minimal. Smithfield Foods agreed to maintain existing contracts of Farmland Food with farmers and with labor (including union representation), continue current production at all facilities and purchasing the past portion of hogs on the cash open market, keep Farmland management and the Farmland brand, and maintain competition in the market. While a merger or absorption of Farmland Food by a smaller but viable firm other than Smithfield in the industry would have advantages, there appears to be no alternative other than for Farmland Food to soldier on if the $363.5 million bid by Smithfield is rejected.

A principal argument for the acquisition is that Farmland Food is unlikely to be a financially viable firm as a stand-alone operation. A weak, small Farmland Food firm would provide no countervailing market power. It would not serve its workers, hog suppliers, creditors, or consumers as well as would its acquisition by Smithfield Foods.

Four firms (Tyson, Smithfield, Swift(Conagra), and Excel) dominate pork processing. After the acquisition, Smithfield Foods' industry sales share will increase from 20 percent to 27 percent. The expanded firm, though large enough to achieve economies in production and marketing and hence compete effectively, will not dominate the industry. Exit of Farmland Food will enhance competition among remaining firms in the industry.

The financial trouble of Farmland Industries is evidence that American agribusiness is competitive. If agribusinesses were exploiting farmers and their profit margins were large, Farmland Industries as a cooperative would have prospered. It does not take many firms to have a competitive industry. The four largest firms in the meat packing industry accounted for 67 percent of industry sales but they earned operating income of only 1.4 cents on each dollar of sales in 1999 (American Meat Institute, p.33). Thus the meat processing industry operates on small profit margins.

I find it useful to divide the impact of greater concentration in an industry into two components: economic power and economies of size. These determine the marketing margin, the difference in price between producer and consumer. Concentration into fewer, larger firms can increase the margin because of greater firm marketing power, or can decrease the margin because of economies attending larger size. Persaud and Tweeten (pp. 131-38) report empirical results from various studies showing that increasing concentration in the hog (also in cattle and turkey) processing industry lowers marketing margins because the economies of size effect dominates the market power effect. That's the good news. The bad news for farmers is that the benefits of lower margins are passed to consumers as lower food prices rather than to farmers as higher hog prices.

That result is consistent with economic theory. No processor, whether a coop, competitive, oligopsonist (one of few firms), or monopolist firm, gratuitously provides farmers a price premium. However, processors must pay adequate sized, competent hog producers their full cost of production on average over time or processors will have no hogs for their plants. That they are doing so is supported by a recent study by Tweeten and

Hopkins (Fig. 1), which found that hog as well as other types of farms of commercial size more than covered full costs.

Popular opinion that a competitive or cooperative processing firm pays farmers a better price than does an oligopsonist firm such as Smithfield is unjustified. Conventional analysis holds that an oligopsonist firm (one of few buyers) of hogs uses market power to force producers to sell farther down their supply curve—at a lower price and quantity—than would a competitive firm. This line of reasoning ignores that a competitive firm and industry cannot afford to advertise and perform research. The oligopsonistic food marketing sector has innovated and advertised so effectively that Americans chronically overeat as apparent in nearly two-thirds of adults being overweight and nearly one-third being obese. That is unfortunate indeed from a nutritional standpoint but the important point here is that oligopsony expands food demand so that farmers operate higher on their supply curve—at a higher price and quantity—than they would with a processing-marketing sector made up of many small cooperatives or private firms.

Whatever its immediate promises for maintaining the status quo as noted in the opening paragraph of this statement, Smithfield Foods is a dynamic firm, hence it will change as necessary to remain competitive. Several considerations suggest that the parties to this acquisition will be best served by changes discussed below that Smithfield is likely to undertake over time. The firm is likely to move to larger and more widely spaced plants and to greater use of production and marketing contracts. At issue is whether that is a bad thing for producers, consumers, and the environment.

Many farmers understandably are concerned about the trend to fewer and larger processing plants and to fewer cash markets. Hog producers have access to large trucks and hard surface highways that allow economical shipping a hundred miles or more to hog processors. Thus not having several processing facilities within a few miles does not condemn a hog producer to no competition for hogs and low economic returns.

Smithfield Foods has a tradition of contract production and is likely to expand that strategy used also at Farmland Food. Cash markets are likely to continue to shrink. An important point is that cash open markets are not essential to a competitive, efficient market. Production and marketing contracts are subject to the same laws of supply and demand that govern cash markets. If farmers do not cover costs over time with contracts, they will find other marketing arrangements or exit the industry. Farmers are far more competent and need less cosseting than populists give them credit for. Farmers are adept at finding their best opportunities, whether they be near or far, with hogs or other enterprises, with a large or small processor, with a stand-alone or conglomerate operation, with a cooperative or private firm, or in a contract or cash market. Contract production is standard in many industries outside of agriculture. Such contracts are a useful way of doing business where coordination through contracts is cheaper than through the price system operating at each stage of the marketing chain.

A related concern is that contracting has contributed to the trend to fewer and larger farms to gain countervailing market power. In Ohio, a typical hog barn (module) in an integrated production operation finishes 1,000 hogs. Each barn requires about one hour of a worker's time per day. A farmer can work part time by having just a few modules. Serving eight modules is a full time job for one person and that person can finish 2.5 generations of hogs per year. Hence one farmer can finish 20,000 hogs per year.

My father worked pretty hard to send 300 hogs to market each year. Although today's integrated operation is not directly comparable to my father's farrow-to-finish operation, the example does illustrate how an integrated operation replaces many traditional family hog farms. On the other hand, production contracts used widely by Smithfield and its subsidiaries reduce risk and managerial demands while increasing availability of credit to farmers, thereby helping to preserve many family farms. Thus vertical coordination is a mixed blessing to the family farm.

Labor efficiency was advanced by vertical coordination, but the underlying structural change in agriculture traces more to technology than contracting. The shift away from traditional small farms to labor-saving technology would have occurred, albeit belatedly, without vertical integration and even if pork processors would have remained small.

A final issue is whether acquisition of Farmland Food will damage the environment by increasing farm and processing plant size. The implicit assumption is that large operations are more damaging to the environment than are small operations. Some knowledgeable economists contend that environmental problems can be dealt with more cheaply on large farms than on small farms (see Tweeten and Flora, p. 30). More analysis is essential to resolve that issue. It is notable that Smithfield Farms has been a leader in funding research on better ways to control flies and odors and dispose of waste on hog farms.

In conclusion, benefits overshadow costs to hog producers and consumers from the acquisition of Farmland Food by Smithfield Foods. The acquisition is another manifestation of a worldwide structural change that frees labor from producing food to supplying education, health care, entertainment, and other manifestations of an advanced economy. Increased efficiency of labor and other resources in agriculture over time accounts for our high current living standard, and, indeed, for civilization itself. Government interventions could attempt to preserve the status quo in agriculture but at high cost in lost living standards.

I made the case that farmers are adept at seeking out their best opportunities to improve their economic situation. Public reporting of terms of production and marketing contracts would facilitate that effort. The challenge of transparency is great because contracts often have unique features, but a joint effort between farmers, agribusiness firms, public administrators, and academics holds promise to develop a reporting procedure. Full reporting would improve immediate market information as well as research into how payoffs differ among regions, firms, and farmers in a world of contract production.

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